

Policy statement

Regulatory framework for  
the New Payments  
Architecture central  
infrastructure services

December 2021

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# 1 Executive summary

- 1.1** In this document, we set out the regulatory framework we will implement to address risks to competition and innovation arising from the behaviour of a provider of central infrastructure services (CIS) for the New Payments Architecture (NPA).
- 1.2** Our framework will reduce the ability and incentive of a CIS provider to act in ways that distort competition or stifle innovation to the detriment of people and businesses. It places obligations on Pay.UK and a CIS provider. We plan to give directions to implement our regulatory framework before the NPA goes live using our Financial Services (Banking Reform) Act 2013 (FSBRA) powers.

## The renewal of the UK's interbank payment systems can strengthen competition and support innovation

- 1.3** Every day, millions of us rely on interbank payments (payments that are made from one payment account to another); whether receiving wages or benefits via Bacs, paying bills using Direct Debit, or transferring money to a friend using internet or mobile banking via Faster Payments.
- 1.4** The NPA is the payment industry's proposed way of organising the clearing and settlement of most interbank payments in the future, including those that currently use Bacs and Faster Payments. We support this initiative because, delivered well, it can help realise the outcomes we want to bring about in payments and facilitate our proposed long-term strategy. By strengthening competition and innovation in payment services and between payment systems, the NPA can help provide better value and effective choice of payment options for people and businesses. The NPA can also improve the resilience of payments and, by enabling more data to be included in payment messages, help reduce fraud.
- 1.5** Pay.UK, the operator of Bacs and Faster Payments, is responsible for delivering the NPA. This includes procuring a provider of NPA CIS. Pay.UK is also responsible for the design of the NPA. One of the design principles for the NPA is that the scope of services provided centrally by a single supplier should be minimised, with third parties competing in the provision of overlay services where appropriate. Examples of potential overlay services include services to identify and prevent fraud, services that facilitate connection to the CIS and services that support end users in initiating or receiving payments.

## Risks to competition and innovation from a CIS provider's behaviour

**1.6** In Chapter 5 of our February consultation paper, *Delivery and regulation of the New Payments Architecture (CP21/2)*, we described three sets of risks to competition and innovation in the NPA ecosystem that could arise from the behaviour of a CIS provider:

- **Monopoly risks.** A CIS provider might not have strong incentives to control costs and margins or improve services, leading to higher CIS user prices and inferior service quality for CIS users.
- **Horizontal competition risks.** If a CIS provider (or an affiliate) has a significant interest in another payment system, it could try to give an unfair advantage to that payment system to the detriment of the NPA.
- **Vertical competition risks.** If a CIS provider (or an affiliate) has a significant interest in overlay services, it could have an unfair advantage over other providers of similar services.

**1.7** To address these risks, we proposed technical design principles that Pay.UK should follow in developing the NPA. We also proposed a package of specific mitigations and governance principles designed to reduce the ability and incentive of a CIS provider to distort competition or stifle innovation. In CP21/2, we proposed to bring forward regulatory measures to ensure these specific mitigations and governance principles are implemented.

**1.8** 28 stakeholders responded to CP21/2 with comments on our proposals for mitigating risks to competition and innovation. Most respondents agreed or broadly agreed with our assessment of the risks and the specific mitigations and governance principles we proposed to address these risks. Some respondents, though, said that some or all of the risks were theoretical or unlikely to occur. Some respondents also said that any intervention we make must be proportionate to the risks identified and set the outcomes we want to see delivered rather than detailed prescriptive rules.

**1.9** Having carefully considered these responses, we remain of the view that there are risks to competition and innovation from a CIS provider being a monopolist and from it (or an affiliate) potentially having a significant interest in another payment system or in overlay services. If these risks materialise, competition in payment services or between payment systems would be distorted or dampened, leading to higher prices, lower quality of service and less innovation. The scale of the harm could be significant.

**1.10** Our economy and society depend on interbank payments. Bacs and Faster Payments, which the NPA is intended to replace, accounted for nearly £7 trillion of payments in 2020 and are used by millions of us every day to pay bills or transfer money to a friend. In the future, interbank payments could also be used more often to pay for shopping and in new use cases, leading to more choice and better value for people and businesses from stronger competition between payment systems.

## How our regulatory framework addresses these risks

**1.11** Our regulatory framework will reduce the likelihood of the risks occurring and help ensure that the NPA delivers outcomes that support our statutory objectives to promote competition, innovation and the interests of service-users. It consists of:

- requirements on Pay.UK to take steps to help lower the risks to competition and innovation
- requirements on a CIS provider

### Requirements on Pay.UK

**1.12** Box 1 summarises the requirements on Pay.UK. We consider these requirements, together with the technical design principles and the existing obligations on Pay.UK to select a CIS provider through a competitive procurement process, will prevent or reduce the likelihood that a CIS provider:

- exploits its position as the monopoly provider of CIS
- gives an unfair advantage to another payment system in which it (or an affiliate) has a significant interest to the detriment of the NPA
- gains an unfair competitive advantage in the provision of a competitive overlay service in which it (or an affiliate) has a significant interest

#### **Box 1: Summary of requirements on Pay.UK**

Pay.UK must:

- be the primary interface and decision-maker for CIS provision
- set CIS user prices, and do so using a methodology that has regard to certain pricing principles and is subject to our non-objection
- set the rules and standards for NPA CIS, and ensure that these facilitate competition and innovation
- ensure that CIS facilitate innovation and competition
- ensure that a CIS provider does not use or disclose to any other party, including its affiliates, information and data for anything other than CIS provision
- in a timely manner, make available to the market, information and data concerning the provision of CIS that would help facilitate competition or innovation

## Requirements on a CIS provider

- 1.13** Box 2 sets out the requirements on a CIS provider to operationally separate its CIS functions from other parts of its (or an affiliate's) business. These requirements only apply if a CIS provider (or an affiliate) has a significant interest in another payment system or in overlay services. Where a CIS provider does not have such an interest, it must notify us if this might change due to any proposed action or change in circumstances and in any event report annually on its position.
- 1.14** While the requirements on Pay.UK set out in Box 1 will reduce the ability and incentive of a CIS provider to distort competition or stifle innovation, incentives and opportunities for a CIS provider to do so will remain. The requirement on a CIS provider to operationally separate its CIS functions from other parts of its (or an affiliate's) business where it (or an affiliate) has a significant interest in another payment system or in overlay services will further reduce these incentives and opportunities.

### **Box 2: Summary of requirements on a CIS provider if it (or an affiliate) has a significant interest in another payment system or in overlay services**

- If a CIS provider (or an affiliate) has a significant interest in another payment system, or in overlay services, its CIS functions must be operationally separate from other parts of its (or an affiliate's) business.
- A CIS provider that is subject to this requirement must ensure that the operational separation implemented adheres to certain principles including that provision of CIS is not unduly influenced by a CIS provider's or an affiliate's interest in providing services other than CIS.

## Next steps

- 1.15** Publishing our regulatory framework now provides clarity for stakeholders, particularly Pay.UK and potential CIS providers, about our intentions. In parallel to the NPA CIS procurement process, we plan to engage with Pay.UK and bidders to understand how they intend to comply with our regulatory framework and to make our expectations clear. If a bidder meets either of the criteria requiring operational separation (that is, it or an affiliate has a significant interest in another payment system or in overlay services), we will engage with them on their proposals for implementing this as soon as possible and well in advance of any CIS contract being signed.

- 1.16** Our regulatory framework is based on our assessment of the information currently available to us about the risks to competition and innovation arising from the behaviour of a CIS provider. We are, however, mindful that we are publishing our regulatory framework at an early stage in the delivery of the NPA. We will monitor the delivery of the NPA including the CIS procurement and the development of overlay services. If we find that new risks have emerged or circumstances have changed, or that competition and innovation are not developing effectively in the NPA, then we will consider introducing different or further regulation. We would also be open to suggestions from stakeholders about other ways the risks could be mitigated.
- 1.17** FSBRA enables Her Majesty's Treasury (the Treasury) to designate payment systems and thereby bring them into the scope of regulation by the PSR. This paper, and the illustrative directions published alongside it, have been developed on the basis of a scenario where the Treasury decides to designate the NPA, or aspects of it, as a regulated payment system. Any potential designation of the NPA will be subject to the procedure for designation established in FSBRA, and is at the discretion of the Treasury.
- 1.18** We publish the illustrative directions to illustrate to stakeholders – particularly Pay.UK and bidders participating in any CIS procurement – how the directions we plan to give to implement our regulatory framework could look. We are not seeking comments on the illustrative directions.
- 1.19** We plan to publish and consult on draft directions closer to the go-live date for the NPA (which, according to Pay.UK's baseline plan will be in mid-2024) before giving them to Pay.UK and any relevant CIS provider. The draft directions we consult on may differ from those published alongside this document (in particular, to take account of the circumstances at the time including any changes to the design of the NPA). Once our directions are in force, we will monitor the actions taken to comply with them.



## 2 Introduction

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Delivered well, the NPA can help realise the outcomes we want to bring about in payments and facilitate our proposed long-term strategy.

We consider, though, that there are risks to competition and innovation in the NPA ecosystem from a CIS provider being a monopolist and from it (or an affiliate) potentially having a significant interest in another payment systems or in overlay services.

We will implement a package of requirements to address these risks, which will help create the conditions for effective competition and innovation in the NPA ecosystem. We refer to these requirements as the NPA CIS regulatory framework.

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- 2.1** In February 2021, we published a consultation paper (CP21/2)<sup>1</sup> on delivery and regulation of the NPA, setting out:
- options for reducing risks to the successful delivery of the NPA, which we considered to be unacceptably high
  - proposals for mitigating risks to competition and innovation relating to when the NPA is operational
- 2.2** This document sets out the package of requirements we will implement to address risks to competition and innovation stemming from the behaviour of a CIS provider. Together, we refer to these requirements as the NPA CIS regulatory framework.
- 2.3** We published a policy statement (CP21/8) setting out our decisions on reducing risks to successful delivery of the NPA in July 2021.<sup>2</sup>

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1 PSR CP21/2, *Delivery and regulation of the New Payments Architecture* (2021). See: <https://psr.org.uk/publications/consultations/cp21-2-consultation-on-delivery-and-regulation-of-the-new-payments-architecture/>

2 PSR CP21/8, *Lowering risks to delivery of the New Payments Architecture* (2021). See: <https://psr.org.uk/publications/consultations/cp21-8-lowering-risks-to-delivery-of-the-new-payments-architecture/>

## The importance of interbank payments and the NPA

- 2.4** Millions of us rely on interbank payments – whether receiving wages or benefits via Bacs, paying bills using Direct Debit, or transferring money using internet or mobile banking via Faster Payments. Bacs and Faster Payments are essential to the smooth functioning of the UK’s economy.
- 2.5** The NPA is the payment industry’s proposed way of organising the clearing and settlement of most interbank payments in the future, including those that currently use Bacs and Faster Payments.
- 2.6** We support this initiative to renew the UK’s retail interbank infrastructure. Delivered well, it can help realise the outcomes we want to bring about in payments and facilitate our proposed long-term strategy.<sup>3</sup> By strengthening competition and innovation in payment services and between payment systems, the NPA can help provide better value and effective choice of payment options for service-users.<sup>4</sup> The NPA can also improve the resilience of payments and, by enabling more data to be included in payment messages, help reduce fraud.
- 2.7** Pay.UK, the operator of Bacs and Faster Payments, is responsible for the design and delivery of the NPA. This role includes procuring CIS for the NPA. Our role is to monitor Pay.UK’s work to deliver the NPA – and use our powers, where appropriate – to assure this happens in a way that supports our statutory objectives to promote competition, innovation and the interests of service-users. We are working closely with the Bank of England, which supervises Bacs and Faster Payments.
- 2.8** Pay.UK’s current design for the NPA consists of the following separate layers:
- **Central infrastructure services (CIS).** The CIS consists of ‘core’ clearing and settlement services (CSS), several common services (each of which has a single provider) and functionality to determine how an individual payment is processed.
  - **Overlay services.** These are services that are not provided as part of the CIS. Pay.UK envisages two types of overlay services:
    - market overlays make use of CIS data or NPA propositions and are provided by third parties to service-users
    - account overlays have no direct dependency on CIS and are provided by third parties to end users to help them in initiating or receiving payments

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3 PSR, *Our proposed PSR Strategy* (2021).

See: <https://www.psr.org.uk/publications/general/our-proposed-strategy/>

4 ‘Service-users’ are those who use, or are likely to use, services provided by payment systems. They include Payment Service Providers and ‘end users’ (such as individual consumers).

- **Payment Service Provider (PSP) services.** These consist of end-user channels, products and services provided by PSPs to their customers (end users), including mobile apps and browser-based applications such as online banking services.

**2.9** The NPA ecosystem comprises the above layers and all the participants<sup>5</sup> in those layers. Annex 1 provides more information on the current design for the NPA.

## Mitigating risks to competition and innovation

**2.10** In Chapter 5 of CP21/2, we described three sets of risks to competition and innovation relating to when the NPA is operational, taking account of the responses we received to our January 2020 call for input<sup>6</sup>:

- **Monopoly risks.** A CIS provider<sup>7</sup> might not have strong incentives to control costs and margins or improve services, leading to higher CIS user<sup>8</sup> prices and inferior service quality for users.
- **Horizontal competition risks.** If a CIS provider (or an affiliate) has a significant interest in another payment system, it could try to give an unfair advantage to that payment system to the detriment of the NPA. For example, a CIS provider might use information and data gained from providing CIS to adapt products or design new services in another payment system.
- **Vertical competition risks.** If a CIS provider (or an affiliate) has a significant interest in overlay services, it could have an unfair advantage over other providers of similar services. For example, a CIS provider could have early or privileged access to information that is not available to third parties, giving it a first-mover or long-term advantage in one or more overlay services.

**2.11** To address these risks, we proposed technical design principles that Pay.UK should follow in developing the NPA (see Annex 2) and to implement the package of measures set out in Table 1.

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5 The term ‘participants’ is used broadly to refer to all parties offering services within the NPA ecosystem and is not limited to PSPs.

6 PSR CP20/2, *Competition and Innovation in the UK’s New Payments Architecture* (2020). See: <https://www.psr.org.uk/publications/consultations/cp20-2-call-for-input-competition-and-innovation-in-the-uk-s-new-payments-architecture/>

7 There may be separate providers of CSS and some common services. Accordingly, in this document, we use the term ‘a CIS provider’ to refer to either a single entity providing both CSS and common services or separate monopoly providers of CSS and common services.

8 A ‘CIS user’ is any participant that pays for using CIS. Typically, this will be a participant that connects directly to the CIS or has another direct dependency on using its data or services – for example, direct PSPs or providers of market overlays.

**Table 1: Our proposed package of measures in CP21/2**

|                              |   |
|------------------------------|---|
| <b>Specific mitigations</b>  | Require Pay.UK to run an effective procurement process  |
|                              | Require Pay.UK to ensure that the contract with a CIS provider includes incentives to foster and facilitate innovation, and limits incentives to distort competition  |
|                              | Require Pay.UK to prevent a CIS provider (or its owner) using commercially sensitive information for its own benefit in another market  |
|                              | Require Pay.UK to include, and then monitor, service level agreements (SLAs) in a CIS provider contract   |
|                              | Require Pay.UK to ensure CIS user prices are set using proportionate, objective and non-discriminatory (POND) criteria and follow the pricing principles  |
| <b>Governance principles</b> | Pay.UK should be the primary interface and decision-maker for all matters relating to CIS provision   |
|                              | Pay.UK must actively implement rules to promote competition and ensure access terms are POND  |
|                              | If a CIS provider (or its owner) has a significant interest in another payment system that competes with interbank payments or in the NPA's competitive overlay markets, its CIS functions must be operationally separate   |
| <b>Pricing principles</b>    | <p>CIS prices must be set using POND criteria and follow five principles:</p> <ul style="list-style-type: none"> <li>• reflect efficiently incurred costs</li> <li>• incentivise utilisation of the NPA</li> <li>• foster competition in services to end users</li> <li>• be transparent and predictable</li> <li>• adapt to changing competitive conditions</li> </ul> |

**2.12** 28 stakeholders responded to CP21/2 with comments on our proposals for mitigating risks to competition and innovation. These included large users, PSPs, technology service providers and trade associations. We published non-confidential versions of the responses we received to CP21/2 in July 2021.<sup>9</sup> We have taken account of respondents' views in developing our regulatory framework.

<sup>9</sup> Non-confidential versions of responses to CP21/2 are here: <https://psr.org.uk/publications/consultations/cp21-8-lowering-risks-to-delivery-of-the-new-payments-architecture/>

- 2.13** Most respondents agreed or broadly agreed with our assessment of the risks to competition and innovation and the measures we proposed to address these risks. Some respondents, though, said that some or all of the risks were theoretical or unlikely to occur. Some respondents also said that any intervention we make must be proportionate to the risks identified and set out the outcomes we want to see delivered rather than detailed prescriptive rules.
- 2.14** We remain of the view that there are risks to competition and innovation from a CIS provider being a monopolist and from it (or an affiliate) potentially having a significant interest in another payment system or in overlay services. If these risks materialise, competition would be distorted or dampened, or innovation stifled, to the detriment of people and businesses and the overall benefits case for the NPA. Annex 2 summarises and responds to the comments we received on our assessment of the risks to competition and innovation, as well as some of the other questions we asked in CP21/2.
- 2.15** In this document, we set out a regulatory framework for the NPA CIS that, together with the technical design principles (see Annex 2) and the existing obligations on Pay.UK to select a CIS provider through a competitive procurement process (see CP21/8), reduces the ability and incentive of a CIS provider to act in ways that distort competition or stifle innovation. Our framework places obligations on Pay.UK and a CIS provider. It strikes an appropriate balance, providing clarity on our expectations while avoiding being unduly prescriptive. Our framework takes account of the comments we received on the proposed package of measures we set out in CP21/2.
- 2.16** In parallel to the CIS procurement, we plan to engage closely with Pay.UK and bidders to understand how they intend to comply with our regulatory framework once it is implemented and to make our expectations clear. If a bidder meets either of the criteria requiring operational separation (that is, it or an affiliate has a significant interest in another payment system or in overlay services – see paragraph 3.5), we will engage with them on their proposals for implementing this as soon as possible and well in advance of any CIS contract being signed.
- 2.17** Our regulatory framework is based on our assessment of the information currently available to us about the risks to competition and innovation arising from the behaviour of a CIS provider, including the responses we received to CP21/2. We are, however, mindful that we are publishing our regulatory framework at a time when the procurement of the CIS is at an early stage and the precise design of the NPA and the identity of the CIS provider – among other things – are not yet known.
- 2.18** We will monitor the delivery of the NPA, including the CIS procurement and the development of overlay services.<sup>10</sup> If we find that new risks have emerged or circumstances have changed, or that competition and innovation are not effectively developing in the NPA, then we will consider introducing different or further regulation. We would also be open to suggestions from stakeholders about other ways the risks could be mitigated.

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<sup>10</sup> Overlay services are not directly regulated by our NPA CIS regulatory framework.

- 2.19** We plan to give directions using our FSBRA powers to implement our regulatory framework. These directions would be imposed on Pay.UK (irrespective of who provides CIS) and on a CIS provider. The direction that applies to a CIS provider depends on whether or not it (or an affiliate) has a significant interest in another payment system or in overlay services. If it does, the direction would require operational separation. If not, the direction would require a CIS provider to notify us if this might change due to any proposed action or change in circumstances and in any event report annually on its position.
- 2.20** Annex 3 of this document sets out illustrative directions that are examples of how we would implement our regulatory framework. We are publishing Annex 3 to illustrate to stakeholders – particularly Pay.UK and bidders participating in any CIS procurement – how the directions we plan to give to implement our regulatory framework could look. We are not seeking comments on the illustrative directions. We plan to publish and consult on draft directions closer to the go-live date for the NPA before giving them to Pay.UK and a CIS provider. According to Pay.UK’s baseline plan, the NPA will go live in mid-2024.
- 2.21** The rest of this document is structured as follows:
- Chapter 3 sets out the requirements on Pay.UK to take steps to help lower the risks to competition and innovation.
  - Chapter 4 sets out the principles to which Pay.UK must have regard when setting CIS user prices.
  - Chapter 5 sets out the requirements we will place on a CIS provider.
- 2.22** Annex 1 provides an overview of the current design for the NPA. Annex 2 summarises and responds to respondents’ comments that are not covered in Chapters 3 to 5. Annex 3 sets out illustrative directions that are examples of how we would implement our regulatory framework.

# 3 The role of Pay.UK

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To help ensure that CIS provision supports competition and innovation in the NPA ecosystem, Pay.UK must:

- be the primary interface and decision-maker for CIS provision
- set CIS user prices, and do so using a methodology that has regard to certain pricing principles and is subject to our non-objection
- set the rules and standards for CIS, and ensure that these facilitate competition and innovation
- ensure that CIS facilitates innovation and competition
- ensure that a CIS provider does not use or disclose to any other party, including its affiliates, information and data for anything other than CIS provision
- in a timely manner, make available to the market information and data concerning the provision of CIS that would help facilitate competition or innovation

Pay.UK must publish an initial compliance statement setting out how it intends to comply with these requirements, followed by an annual compliance statement thereafter. In addition, Pay.UK must inform the PSR of any material decisions or changes to its operations that affect its compliance.

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## Introduction

**3.1** In CP21/2 we proposed five specific mitigations and two governance principles (see Table 1 in Chapter 2) that would apply to Pay.UK. Most of the 24 respondents that commented on these measures agreed or broadly agreed with our proposals. Others did not express a clear view or were not convinced of the need for regulatory intervention to implement the proposed specific mitigations and governance principles. Around a third of respondents, including four larger and two smaller PSPs, all of which otherwise agreed with at least some of our proposals, said that the specific mitigations and governance principles would benefit from clarification and a greater focus on outcomes. Some respondents, including Pay.UK and UK Finance, also emphasised that the framework should more clearly differentiate between our role as the regulator and Pay.UK's role as the intended operator of the NPA.

**3.2** Our view remains that Pay.UK has an important role to play to help facilitate competition and innovation in the NPA ecosystem, while ensuring payment systems are resilient and robust. We have decided to introduce requirements on Pay.UK specifying what it must do to carry out this role effectively in relation to the provision of CIS. Taking account of the responses we received to CP21/2, we have simplified and

clarified our proposals. We have consolidated the specific mitigations and governance principles into a single set of requirements, and, where appropriate, made clearer the link between the requirements and their intended outcomes.

- 3.3** To comply with our regulatory framework and help facilitate competition and innovation in the NPA ecosystem, Pay.UK must have sufficient capabilities. Pay.UK has time to further build these capabilities over the coming years before the NPA goes live (which is due to happen in mid-2024 according to Pay.UK's baseline plan).
- 3.4** This chapter presents the requirements that will apply to Pay.UK. For each requirement, we summarise and respond to respondents' views on the equivalent proposal in CP21/2, and we explain how our final requirement will help mitigate identified competition risks.
- 3.5** Throughout this document, we refer to the possibility of a CIS provider or an affiliate having a 'significant interest' in another payment system or in overlay services. Box 3 explains what we mean.

### **Box 3: Significant interest of a CIS provider or an affiliate**

A CIS provider or an affiliate has a significant interest if it:

- a. participates<sup>11</sup> in a payment system that competes, or can be expected to compete, with the NPA payment system, or
- b. is active in NPA overlay services.

An affiliate means:

- a. a person that is part of the same undertaking as the CIS provider, or
- b. another business or enterprise over which the CIS provider, or another part of the undertaking to which the CIS provider belongs, has at least the ability to exercise material influence.

By 'undertaking' we mean an undertaking within the meaning of Chapters 1 and 2 of the Competition Act 1998.

In considering whether a CIS provider, or another part of the undertaking, has at least the ability to exercise material influence over another business or enterprise, we will have regard to the factors set out by the Competition and Markets Authority in its document *Mergers: Guidance on the CMA's jurisdiction and procedure*<sup>12</sup> (December 2020), especially paragraphs 4.21 to 4.36).

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11 For participants in payment systems, see section 42 of FSBRA.

12 See: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/987640/Guidance\\_on\\_the\\_CMA\\_s\\_jurisdiction\\_and\\_procedure\\_2020.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987640/Guidance_on_the_CMA_s_jurisdiction_and_procedure_2020.pdf)



## Pay.UK as the primary interface and decision-maker for CIS provision

### Respondents' views

- 3.6** The first governance principle we proposed in CP21/2 was that Pay.UK should be the primary interface and decision-maker for all matters relating to CIS provision.
- 3.7** Most respondents agreed with our proposed requirement. Some respondents, such as Pay.UK, two large PSPs and a smaller PSP, asked for more detail on the precise boundary of the requirement while agreeing with our proposal in principle (with the exception of one of the large PSPs). Some respondents, including UK Finance and Pay.UK, argued that there must be some practical limitations to Pay.UK's role to avoid unnecessary inefficiency in the delivery of CIS, especially considering that the CIS provider often has the required expertise to provide services and answer queries. One large PSP was concerned that this principle, in the absence of specific boundaries, could set a role too burdensome and wide for Pay.UK to carry out effectively.
- 3.8** Two large PSPs said that Pay.UK is already the primary interface and decision-maker for all matters relating to central infrastructure for Bacs and Faster Payments, and that our proposed governance principle would not change the status quo.
- 3.9** UK Finance had concerns with our proposed governance principle on the grounds of proportionality. It explained that it would 'lay too great a responsibility on Pay.UK and centralise to an unhealthy degree the decision-making powers of Pay.UK'. UK Finance argued that individual participants might plan to bring to market services that consume CIS and which may 'necessitate negotiation outside of a collaborative industry body'. Holding Pay.UK accountable for such negotiations and for the entire ecosystem as a whole could thus inhibit rather than promote competition and innovation. UK Finance also said that some of its members remain unsure whether the existing 'governance models are suitable to ensure the adequate implementation of the NPA and effective management of its running' and that 'in light of this the suggestion by the PSR to increase the strength of existing Pay.UK governance is not supported by industry without a proper articulation of the limits of this strengthening and the expected outcomes'.

### Our response

- 3.10** We have decided that **Pay.UK must be the primary interface and decision-maker for CIS provision** to mitigate monopoly, horizontal and vertical competition risks.

- 3.11** This requirement will help reduce the risk that Pay.UK and the NPA could, over time, increasingly rely on a monopolistic, incumbent CIS provider. Such overreliance on a CIS provider, with Pay.UK taking on a more passive role, would strengthen a CIS provider's ability to affect and influence strategic decisions about the NPA to its own benefit. Where overreliance on a CIS provider's expertise in turn results in a lack of expertise about CIS within Pay.UK, this could create a **monopoly risk** by putting an incumbent CIS provider at a competitive advantage in any future CIS procurement exercises.
- 3.12** If a CIS provider (or an affiliate) has a significant interest in another payment system, the requirement also helps address **horizontal competition risks** by reducing the ability of a CIS provider to:
- take decisions that benefit another payment system to the detriment of the NPA or reduce competition between payment systems, because Pay.UK is primarily responsible for decisions relating to CIS provision
  - exploit information and data it has access to as a CIS provider to give an unfair advantage to another payment system, because new and existing participants primarily interact with Pay.UK on CIS provision
- 3.13** If a CIS provider (or an affiliate) has a significant interest in overlay services, the requirement helps address **vertical competition risks** by reducing the ability of a CIS provider to:
- take decisions that discriminate against other overlay providers, because Pay.UK is primarily responsible for decisions relating to CIS provision
  - gain an unfair advantage over other overlay providers by exploiting information and data it has access to as a CIS provider, because new and existing participants primarily interact with Pay.UK on CIS provision
- 3.14** A few respondents expressed the view that our requirement would not change the status quo because Pay.UK is already acting as the primary interface for Bacs and Faster Payments. We cannot assume that practices in existing payment systems, even if they were sufficient, would be replicated for the NPA. Some smaller participants have also told us that, at times, their engagement with the incumbent provider of central infrastructure for Bacs and Faster Payments (Vocalink) has not been prioritised sufficiently and are also unclear who (Pay.UK or Vocalink) is responsible and accountable for certain services. Our requirement seeks to avoid such issues arising in relation to the NPA CIS.
- 3.15** Some respondents asked for clarity on the boundaries of the requirement, arguing that it could introduce unnecessary inefficiency if applied in all circumstances. To clarify, our requirement refers to Pay.UK being the 'primary' interface because we recognise that there may be instances when direct interaction between a CIS provider and participants might be beneficial overall. For example, Pay.UK might outsource operational services such as helpdesks to a CIS provider.

**3.16** Being the **primary interface** means that Pay.UK must be the party that engages with a CIS user concerning the (potential) provision of CIS except where direct engagement between a CIS provider and a CIS user would not result in a material risk that:

- competition or innovation will be reduced, or
- a CIS provider will be able to take advantage of its position as a monopoly provider of services – for example, that a CIS provider could share any information it might obtain via its direct engagement with participants with other parts of its business or affiliates

**3.17** Where Pay.UK permits interaction between a CIS provider and participants, it must retain overall accountability for the delivery of services provided to participants.

**3.18** Within these boundaries, Pay.UK should be well placed to make an initial assessment of the matters that can be left to direct interaction between a CIS provider and participants. Pay.UK will have to set its approach out in its initial compliance statement.

**3.19** Our requirement also sets out that Pay.UK must be the **primary decision-maker** for CIS provision. It has to be the decision-maker on certain matters relating, for example, to CIS scope and functionality, including the transparent and impartial prioritisation of change requests. Box 4 provides the list of matters on which Pay.UK must remain the decision-maker. Pay.UK may permit a CIS provider to take decisions on other matters but only if the same conditions that apply to the primary interface role are met (see paragraph 3.16).

#### **Box 4: Matters on which Pay.UK must be the primary decision-maker**

Pay.UK, and not a CIS provider, must always be the decision-maker concerning:

- whether to provide CIS
- whether to terminate CIS provision
- the terms (including the prices) on which CIS are provided
- the type of CIS that is provided
- whether to change the type or scope of the CIS provided, including whether to agree to a request by a CIS user to do so
- the priority of a CIS user's request to change the type or scope of the CIS provided
- the rules and standards concerning the provision of CIS
- the service levels provided to CIS users

**3.20** UK Finance said that some of its members questioned the increased centralisation of decision-making in Pay.UK. In a model that uses a single, monopolistic CIS provider, decisions about CIS are made centrally – either by the CIS provider or by Pay.UK. Ensuring they are made by Pay.UK helps mitigate some of the competition risks we identified (see Chapter 2) and which are the result of commercial incentives that a CIS

provider might have. We agree, though, that Pay.UK needs to have robust and effective governance and decision-making arrangements. It must have the right capabilities to be effective as the primary interface and decision-maker. We are monitoring closely Pay.UK's work to further build its capabilities.

## Pay.UK must set CIS user prices

### Respondents' views

- 3.21** In CP21/2, we proposed that Pay.UK must ensure that CIS user prices are set using POND criteria and follow pricing principles we set.
- 3.22** Most respondents agreed with our proposed requirement. One large PSP supported the proposal in general. It said, however, that the degree of flexibility Pay.UK might have in setting CIS user prices will be limited in practice as a CIS provider will have to recover its costs plus a reasonable return on its investment. UK Finance agreed with the principle behind the proposal but was not convinced of the need for additional requirements as Pay.UK already applies POND principles.
- 3.23** Chapter 4 summarises respondents' views on the individual pricing principles.

### Our response

- 3.24** We have decided that **Pay.UK must set CIS user prices, and do so using a methodology that has regard to certain pricing principles and is subject to our non-objection** to mitigate monopoly, horizontal and vertical competition risks.
- 3.25** By ensuring that Pay.UK, and not a CIS provider, is responsible for setting CIS user prices, the requirement helps address:
- the **monopoly risk** that a CIS provider sets CIS user prices to maximise its profits to the detriment of service-users
  - the **horizontal competition risk** that a CIS provider that has a significant interest in another payment system or has an affiliate with such an interest sets CIS user prices that benefit that payment system to the detriment of the NPA
  - the **vertical competition risk** that a CIS provider that has a significant interest in overlay services or has an affiliate with such an interest engages in price discrimination against other overlay providers<sup>13</sup>

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<sup>13</sup> As explained in CP21/2 and set out in Annex 2 of this policy statement, vertical risks relating to pricing or quality of service provision do not apply for the provision of account overlays because account overlays do not directly use CIS or CIS data.

- 3.26** The way CIS user prices are set will have important implications for competition and innovation. This includes the incentives on parties to use the NPA and their decisions about the products and services they offer. For this reason, our requirement also states that Pay.UK's CIS user pricing methodology has regard to certain pricing principles and is subject to our non-objection. Chapter 4 sets out these principles and how the non-objection process works.
- 3.27** A CIS provider or an affiliate could have a competitive advantage in providing market overlay services if the output and pricing decisions of a CIS provider's affiliate in the overlay market are influenced by the marginal cost of CIS to the group as a whole, which is likely to be lower than the user price faced by its competitors. This in turn could affect the balance of incentives between CIS affiliate and non-affiliate companies to enter and compete in market overlays. We discuss this issue in more detail in Chapter 4.
- 3.28** The requirement on Pay.UK to set CIS user prices no longer explicitly states that these prices must be POND (unlike the proposed requirement in CP21/2). We expect General Direction 2 (GD2) to apply to the operator of the NPA. GD2 requires operators of certain payment systems to have access requirements that are POND.<sup>14</sup>

## Pay.UK to set rules and standards for CIS

### Respondents' views

- 3.29** Most respondents to CP21/2 broadly welcomed our proposed requirement (the second governance principle) that Pay.UK must actively implement rules to promote competition and ensure access terms are POND. Respondents of all types agreed that access to CIS should be fair, and appropriately open and equitable.
- 3.30** Pay.UK commented that any requirements needed to be consistent with its roles and powers to carry out its legal duties as a payment system operator. It pointed out that its role, as set out in its articles of association, is to enable competition and that, in this context, it cannot take on responsibility for proactive 'promotion' of competition. Pay.UK instead considered this to be a duty for us. UK Finance argued that Pay.UK should enable competition, but said that setting rules to promote competition is considerably different to ensuring a level playing field and that such rules would need significant review to ensure they do not result in unforeseen outcomes.

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<sup>14</sup> GD2 is available at: <https://www.psr.org.uk/publications/general/general-direction-2-access-fsbra-2020>. It also imposes certain connected requirements including relating to compliance reporting.

## Our response

- 3.31** We have decided that Pay.UK must set the rules and standards for NPA CIS, and ensure that these facilitate competition and innovation. As part of this role, we expect Pay.UK to consider:
- how to build trust and confidence in payments processed using the NPA
  - how the design of the NPA and its rules can allow participants to connect with CIS in cost-effective ways
  - how it sets rules and standards relating to information and data (see paragraphs 3.46 to 3.51)
- 3.32** Ensuring that Pay.UK, and not a CIS provider, is responsible for setting rules and standards for CIS will help **reduce the reliance on a monopolistic CIS provider** as set out in paragraph 3.11. In addition, the requirement will help address:
- the **horizontal competition risk** that a CIS provider that has a significant interest in another payment system or has an affiliate with such an interest sets CIS rules and standards that benefit that payment system to the detriment of the NPA
  - the **vertical competition risk** that a CIS provider that has a significant interest in overlay services or has an affiliate with such an interest sets CIS rules and standards that discriminate against other overlay providers
- 3.33** We note the comments about our use of the word ‘promote’ in the context of Pay.UK’s rules and standards setting capacity. We have amended the requirement to say Pay.UK must ‘facilitate’ competition as we consider this wording sufficient to achieve our policy objectives and consistent with other aspects of the regulatory framework. We have set out in paragraph 3.31 examples of what we would expect Pay.UK to consider as part of this facilitation role within the rules and standards setting context.
- 3.34** We expect GD2 (which requires, in particular, operators of certain payment systems to have access requirements that are POND) to apply to the NPA operator and therefore do not consider a separate requirement that CIS rules and standards must be POND to be necessary. For clarity, we have separated requirements on data and information governance that were previously covered by our proposed second governance principle in CP21/2 into a distinct requirement (see paragraphs 3.42 to 3.51 below).

## Pay.UK to ensure CIS facilitates innovation and competition

### Respondents' views

- 3.35** Most respondents agreed with our proposal that Pay.UK should ensure that a contract with a CIS provider includes incentives to foster and facilitate innovation, and limits incentives to distort competition.
- 3.36** UK Finance, three large and one smaller PSP, said that it was difficult to see how such incentives could be drafted within a CIS contract in a meaningful fashion. They also said that it was unclear how the requirement would be monitored and measured. Instead, they argued this could result in a tick-box compliance exercise and introduce unnecessary complications into contract negotiations and ultimately service delivery.
- 3.37** UK Finance also said that fostering innovation via competition can be achieved via other means, for example Pay.UK's 'market catalyst' role, and that including incentives in a CIS contract might not be the only or best means to achieve the desired outcome. Overall, UK Finance questioned whether implementing the requirement as proposed in CP21/2 would be a proportionate measure. It said that additional requirements could make the negotiation of the CIS contract more complicated and suggested that existing mitigations were sufficient to address identified competition risks.
- 3.38** One large PSP that agreed with the sentiment of our proposal suggested that such a requirement should instead be phrased in the negative – that nothing in the CIS contract should act as a barrier to innovation.

### Our response

- 3.39** We have decided that **Pay.UK must ensure that CIS facilitate innovation and competition**. It must do this through:
- the rules and standards it sets (see paragraph 3.31)
  - appropriate SLAs in the CIS contract
  - its decisions on how and when CIS should be developed and the level of investment in particular developments

- 3.40** By ensuring that Pay.UK sets service standards and that it, rather than a CIS provider, makes strategic decisions about CIS development and investment allocation, it reduces the ability of a CIS provider to affect CIS development to its own benefit. The application of this requirement helps address:
- the **monopoly risk** that a CIS provider would not have an incentive to maintain CIS quality standards over time where this is of no or limited benefit to it, which in turn could negatively affect the degree to which CIS can facilitate innovation in overlay services
  - the **horizontal competition risk** that a CIS provider that has a significant interest in another payment system or has an affiliate with such an interest seeks to benefit that payment system by delaying or preventing innovation in the NPA
  - the **vertical competition risk** that a CIS provider that has a significant interest in overlay services or has an affiliate with such an interest seeks to delay or prevent innovation in CIS that would benefit other overlay providers

- 3.41** We have considered comments by respondents that the inclusion of contractual obligations is only one way of facilitating innovation, and that such contractual obligations might be difficult to implement in a meaningful fashion. We consider Pay.UK must use appropriate contractual obligations and SLAs to ensure that CIS facilitate competition and innovation, but we acknowledge that this can also be achieved via additional means. This is why our requirement is wider than our CP21/2 proposal.

## Data and information governance

### Respondents' views

- 3.42** Most respondents agreed with our proposed requirement that Pay.UK must prevent a CIS provider (or its owner) using commercially sensitive information for its own benefit in another market. A large PSP agreed that there need to be restrictions in place but cautioned that a balance needs to be struck to avoid inadvertently preventing innovative services from being developed by a CIS provider. Similarly, one smaller PSP said that 'there is value in operational information sharing across markets'.
- 3.43** As part of the second governance principle set out in CP21/2, we also proposed that Pay.UK must ensure that information that could give a CIS provider (or its owner) an advantage is made available to other relevant parties at the same time. We also proposed that Pay.UK should place general restrictions on how a CIS provider can use information and data. Around a third of respondents commented on these proposals specifically.



**3.44** Those that commented agreed with the need for good data and information governance, but three large PSPs argued that there was limited need for additional requirements. Their reasoning was that the CIS provider will be subject to existing laws on good data governance and will not be the 'owner' of payments data. In contrast, one large end user was concerned about how a CIS provider might collect and use data and said that this could warrant additional consultation.

**3.45** A large end user and a large PSP commented on the use and sharing of data within the context of common services provision. The large end user emphasised that 'a competitive market for the supply of tools, analytical insight and other relevant services is dependent on the standards definition around data sharing'. The large PSP said that sharing of common data used for the provision of public goods, such as fraud prevention, should be facilitated where there are strong arguments for data to be shared that outweigh any potential concerns about stifling innovation.

## Our response

**3.46** We have decided that **Pay.UK must:**

- ensure that a CIS provider does not use or disclose to any other party, including its affiliates, information and data for anything other than CIS provision
- in a timely manner, make available to the market information and data concerning the provision of CIS that would help facilitate competition or innovation

**3.47** A CIS provider might have economic incentives to gather and share data and information with its affiliates to attain a competitive advantage in overlay services or to benefit another payment system. Requiring Pay.UK to take reasonable measures to reduce a CIS provider's ability to use such data and information for purposes other than CIS provision (unless the information is publicly available) will help mitigate:

- The **vertical competition risk** that a CIS provider shares with other parts of its business or affiliates that provide overlay services information on plans by new entrants to provide new innovative services or data that it gathers as part of its operations that are not available to possible competitors. This could in turn distort competition within the NPA ecosystem. For example, it could bring to market products whose development require information only it has access to, and thereby establish a monopoly position in some overlay services.
- The **horizontal competition risk** that a CIS provider shares commercially sensitive information (or information only it has access to) with other parts of its business or affiliates in another payment system, thus distorting competition between systems.

**3.48** While a CIS provider (or an affiliate) might not have a significant interest in another payment system or in overlay services, this might change over time – for example, if it merges with another business or when the CIS contract is retendered. Therefore, the requirements on Pay.UK in paragraph 3.46 apply irrespective of whether a CIS provider (or an affiliate) has a significant interest in another payment system or in overlay services.

- 3.49** We consider it important that data and information is made available where it can facilitate innovation or competition. For this reason, we are also requiring Pay.UK to ensure that such data and information is made available to the market in a timely manner, subject to it not being commercially sensitive. In determining which parties should be able to access the relevant information or data and in what timeframe, Pay.UK must start from the position that the information and data should be made available to the entire market at the same time on a non-discriminatory basis. Pay.UK may decide to make such data available on a more limited basis (which could be to only one undertaking) if this would more effectively facilitate competition or innovation.
- 3.50** The requirements in paragraph 3.46 complement our requirement for a CIS provider to implement operational separation (where the criteria requiring this are met). The flow of information is less observable than price or quality of services. Therefore a dual approach – operational separation of a CIS provider and specific requirements on Pay.UK to implement in its data and information governance framework – is necessary to mitigate risks from a CIS provider sharing information with other parts of its business or affiliates as much as possible, while also ensuring that information and data that could be valuable for the improvement and development of services is available to all at the same time.
- 3.51** Some respondents said that a CIS provider typically does not own individual payments data. This might, as suggested by some respondents, reduce its ability to use or share such data (for example considering General Data Protection Regulation (GDPR) obligations). Even if that is the position, our primary concern in this context is not adequate data protection for privacy and security reasons, but the ability of a CIS provider to share commercially valuable information to which it has sole or preferential access. Such information could, for example, also take the form of intelligence about development of novel services a CIS provider might attain in its interactions with participants, or pseudonymised, anonymised or aggregated data that is not available to others. This means that our requirements are necessary. They do not affect the application of legislation on personal data, including GDPR, but serve a different purpose.

## Other consultation paper proposals

### Effective procurement

#### Respondents' views

- 3.52** Only Pay.UK, UK Finance and a smaller PSP commented on our proposed specific mitigation requiring Pay.UK to run an effective procurement process. UK Finance agreed with a general need for effective procurement and said that such a process should result in the selection of a provider that both Pay.UK and industry have confidence in. Pay.UK set out how it intends to run an effective procurement and achieve value for money under different procurement scenarios. A smaller PSP commented that existing issues facing Faster Payments, such as the need to connect via networking channels that require expensive physical infrastructure, need to be considered when procuring NPA CIS.

**3.53** A large PSP and two technology services providers commented generally on the purpose and benefits of a competitive procurement. They said that competitive procurement of CIS would help mitigate overall risks to competition, and the large PSP said it would reduce the need for intrusive regulation upfront. The technology service provider, however, argued it would not address risks associated with a CIS provider's knowledge of NPA participants' behaviours.

#### Our response

**3.54** In CP21/8, we confirmed that the obligations on Pay.UK to carry out a competitive procurement under Specific Directions (SDs) 2 and 3 will remain. We will also seek assurances from Pay.UK at specified times about the procurement, which will allow us to monitor the effectiveness of the process. There is, therefore, no need for additional requirements relating to the way CIS is procured.

**3.55** We note the comment by the smaller PSP that the need to invest in expensive physical infrastructure to directly connect to Faster Payments is a barrier to entry. We will consider such concerns as part of our work to seek assurances from Pay.UK at specified times about the design, procurement and implementation of the NPA.

## Service level agreements (SLAs)

#### Respondents' views

**3.56** Most respondents agreed with our proposed requirement that Pay.UK must include, and then monitor, SLAs in a CIS contract. UK Finance and two large PSPs said that the use of SLAs was well-established common practice that Pay.UK is already expected to apply. UK Finance said that these should be agreed upon as part of the negotiation process between Pay.UK and a CIS provider and hence there is no need for us to intervene. UK Finance also said that Pay.UK is best placed to establish appropriate SLAs albeit we may wish to have oversight.

#### Our response

**3.57** We have decided not to have a specific, separate requirement in our regulatory framework that Pay.UK must include SLAs within a CIS contract because we do not believe it is necessary to do so.

**3.58** Appropriate use and monitoring of SLAs are important to mitigate:

- the risk that a CIS provider does not invest sufficiently into CIS and does not maintain a sufficient level of functionality or performance over the contract period to maximise its own profits (a **monopoly risk**) or to benefit another payment system in which it or an affiliate has a significant interest (a **horizontal competition risk**)
- the risk that a CIS provider provides differing levels of service quality to different participants, for example to benefit other parts of its business or affiliates that have a significant interest in overlay services (a **vertical competition risk**)

**3.59** Compliance with other aspects of the regulatory framework, most notably the requirement for Pay.UK to ensure that CIS facilitates innovation and competition, will already make necessary the inclusion of SLAs in a CIS contract. We will monitor whether chosen SLAs adequately protect against identified risks and whether they incentivise good performance, such as by carrying sufficient penalties where agreed service levels are not met, and we will consider further action if necessary.

## Reporting requirements

**3.60** Pay.UK will need to set out its approach to compliance transparently to us and stakeholders. Stakeholders can then raise potential concerns with proposed approaches, and we can identify better the need for potential additional measures in a timely fashion. We will require Pay.UK to:

- publish an initial compliance statement before the NPA goes live that sets out how it intends to comply with each requirement
- publish an annual compliance statement after the NPA goes live in which Pay.UK sets out its compliance against the six requirements
- inform us of any changes to its operations that materially affect its compliance as these arise, for example where Pay.UK intends to outsource additional services (possibly affecting its role as primary interface for CIS)

**3.61** We expect Pay.UK to rely to some extent on contractual agreements with a CIS provider to comply with the requirements set out in this chapter. For this reason, we will also ask Pay.UK to provide us with a draft of its initial compliance statement before a CIS contract is signed. We will engage with Pay.UK to understand their proposals with regards to contractual obligations and to make clear our expectations.

## 4 CIS user pricing

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We will direct Pay.UK to set CIS user prices using a methodology that has regard to five pricing principles. These are for CIS user prices to:

- broadly reflect efficiently incurred costs over the life of infrastructure
- incentivise utilisation of the NPA
- not distort competition in services to end users
- be transparent and predictable
- adapt to changes in market conditions, including CIS provider costs and competition

Pay.UK must notify us of the proposed CIS user pricing methodology. This and any subsequent material changes to CIS user pricing will be subject to our non-objection. Pay.UK must not implement the methodology or material changes to CIS user pricing until we notify it of our non-objection.

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### Introduction

- 4.1** In CP21/2, we proposed that Pay.UK must be able to set and vary CIS user prices. CIS user prices apply to participants which pay for using CIS – such as direct PSPs and market overlay providers. Currently, user prices for Bacs and Faster Payments are set to recover central infrastructure costs – the costs of building, maintaining and operating the central infrastructure, which Pay.UK agrees with the provider of that infrastructure – as well as Pay.UK’s own costs for operating the payment system. Pay.UK is in the process of developing a CIS user pricing methodology for the NPA.
- 4.2** We also proposed pricing principles that Pay.UK should follow in its approach to CIS user pricing (see Table 1 in Chapter 2). We asked for views on the proposed pricing principles and whether they sufficiently mitigate competition risks relating to CIS user pricing.
- 4.3** Respondents broadly supported our proposed pricing principles. Nearly all agreed or broadly agreed that these principles address the competition risks that we set out in CP21/2. Only a small percentage of respondents, including a large PSP, a smaller PSP and a payment system operator, suggested additional principles. UK Finance said that Pay.UK is already facing sufficient incentives to deliver outcomes that are in line with the proposed pricing principles. Therefore it questioned the additional benefits that enforcement of the principles might bring.
- 4.4** As explained in Chapter 3, we will require Pay.UK to set CIS user prices. The way Pay.UK does this will affect competition and innovation in the NPA ecosystem, including the incentives on parties to use the NPA and their decisions to develop

products (such as overlay services) which use the NPA CIS. For this reason, we will require that Pay.UK must set CIS user prices using a methodology that has regard to five pricing principles.

- 4.5** We do not, however, wish to be unduly prescriptive. We also recognise that implementation of the principles may require certain trade-offs to be made. Therefore, we do not demand adherence with each individual pricing principle. Pay.UK must have regard to five pricing principles in setting CIS user prices and demonstrate that they have done so. We also note that – in any event – we expect the operator of the NPA to be subject to the requirements of GD2, in particular that it must offer access on terms that are proportionate, objective and non-discriminatory.
- 4.6** These principles, taken in the round, will help develop an NPA ecosystem that is competitive and accessible to new entrants. This can be expected to deliver benefits – such as new innovative products, higher quality of services and lower price of payments – to those who make and receive payments using the NPA. Pay.UK must notify us of the proposed methodology – this and any subsequent material changes to the methodology will be subject to our non-objection.
- 4.7** In the remainder of this chapter, we set out respondents’ views and the pricing principles that Pay.UK must have regard to when developing a methodology for CIS user prices. We also explain the steps Pay.UK must follow when developing its methodology. Annex 2 summarises and responds to respondents’ suggestions for additional pricing principles.

## Implications of Pay.UK setting CIS user prices

- 4.8** Setting CIS user prices in accordance with our pricing principles will mean that CIS user prices not only recover the CIS contract costs from CIS users but also achieve additional objectives. Specifically, Pay.UK will need to consider how CIS user price level and structures can be used to maximise utilisation of the NPA and ensure a level playing field for participants. In doing so, Pay.UK would be acting in accordance with the same incentives as any commercial operator of a payment system.
- 4.9** Prioritising these objectives, however, may lead to a scenario where payments to the CIS provider and Pay.UK’s charging income at any point in time are not equal – for example, if Pay.UK decides to set CIS user prices low in the early period of operation to ensure that the NPA is priced attractively for potential CIS users.<sup>15</sup> Disparity between payments to the CIS provider and Pay.UK’s charging income at any point in time can also arise for a number of other reasons, for example, a difference between forecasted and realised transaction volumes.
- 4.10** This means that financing and/or cashflow management could be required to cover the difference (between payments to a CIS provider and Pay.UK’s charging income). One option is to recover the differences through legacy system prices. We want Pay.UK to develop a robust plan for allocating CIS costs and/or managing any temporary cashflow

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<sup>15</sup> We would, however, expect the value of payments to a CIS provider to be fully recovered from CIS user prices over the lifetime of the contract. We do not envisage Pay.UK taking on financial risk in that sense.

shortfalls. We expect that over time the sum of Pay.UK's CIS user charges should cover the overall value of the CIS contract, plus Pay.UK's administrative fees (to avoid Pay.UK taking on financial risk).

- 4.11** Additionally, Pay.UK should take account of the risk that a CIS provider's affiliate gains a competitive advantage relative to unaffiliated competitors as a result of the way Pay.UK pays the CIS provider for its services.<sup>16</sup> As we set out in CP21/2, such a distortion may arise if revenues from CIS user per unit prices flow directly to the CIS provider. In such a scenario, if an affiliate pays the same CIS user prices (set by Pay.UK) as any other competing market overlay providers, part of the revenue from CIS user prices may flow back to the CIS provider as remuneration it receives for providing CIS. This would result in a lower marginal cost of CIS to the group as a whole (including the affiliate) compared to the CIS user price faced by the affiliate's competitors. This is likely to affect the affiliate's output and pricing decisions in overlay services, distorting the balance of incentives between the affiliate and non-affiliate companies to enter and compete.
- 4.12** One potential solution is for a CIS provider to receive a fixed per-term payment that does not vary with usage – in particular, a CIS provider's remuneration should not increase as the affiliate's usage of CIS increases. Then if the CIS user prices – which are set by Pay.UK and are paid to Pay.UK – are the same for a CIS provider's affiliate and other CIS users, marginal cost of CIS usage would be the same for the affiliate as for its competitors.
- 4.13** As part of our work to seek assurance from Pay.UK at specified times about the design, procurement and implementation of the NPA, we will ask for information on how the CIS provider will be paid for its services and how this addresses the issue identified in paragraph 4.11.

## Pricing principles

### Pricing principle 1 (CIS user prices broadly reflect efficiently incurred costs over the life of infrastructure)

#### Respondents' views

- 4.14** Most respondents that commented on the proposed principle that CIS user prices reflect efficiently incurred costs agreed with us that CIS need to be provided efficiently. Also the respondents said that the underlying cost of both the contract with a CIS provider and the costs incurred by Pay.UK must provide value for money.
- 4.15** A quarter of respondents that commented on this pricing principle, including a technology services provider and two large PSPs, said that they expect the NPA to be priced competitively relative to other payment systems including Bacs and Faster Payments. One large PSP said that higher prices, relative to current Bacs and Faster Payments

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<sup>16</sup> The same reasoning applies to another part of a CIS provider's business that provides market overlays.



prices, should only be permitted if there are overarching benefits and clear improvements in user outcomes. A large end user stated that Pay.UK must understand the cost drivers of CIS and provide suitable challenge to providers over the lifetime of the contract.

**4.16** Some respondents, including two large PSPs and the Electronic Money Association (EMA), said that the objective to reflect efficiently incurred costs may need to be balanced against the principle of incentivising utilisation of the NPA – recovering build costs during the initial phase of the contract would lead to higher CIS user prices in that phase compared to subsequent years. This would not incentivise migration of transactions to the NPA. As a solution, two large PSPs suggested that the CIS build cost should be recovered over the length of the contract.

**4.17** UK Finance said that Pay.UK already has incentives to ensure that costs are controlled appropriately and questioned whether this principle would have any additional benefits.

### **Our response**

**4.18** We consider that NPA CIS should be priced competitively such that they offer value for money to service-users and relative to other payment systems. To help achieve this, the first pricing principle is that Pay.UK must set CIS user prices that broadly reflect efficiently incurred costs. In Chapter 6, we set out how we see this (and other) pricing principles in the context of the regulatory framework help us achieve our desired policy objectives.

**4.19** As we set out in CP21/2, our desire to see prices that reflect efficiently incurred costs does not mean we think Pay.UK should automatically favour the cheapest bidder when procuring CIS. Other relevant quality and resilience considerations are also important – such as ensuring that CIS appropriately facilitate competition in overlay services, and that the NPA ecosystem is resilient.

**4.20** We note that competitive and efficient recovery of long-lived infrastructure costs may change over time. For example, an efficient profile of cost recovery may involve low pricing in the early phase of operation, increasing to recover fixed and sunk costs over time. We would expect CIS user prices to be broadly cost reflective over the length of the contract, but not necessarily at any given point in time. We amended the wording of this pricing principle from ‘reflect efficiently incurred costs’ to ‘broadly reflect efficiently incurred costs over the life of infrastructure’ to make this clear. This pricing principle does not place any restrictions on the structure of the price – it could take any form that helps Pay.UK to create an NPA ecosystem that is competitive and accessible to new entrants. Considerations relevant to other pricing principles (in particular, principles 2 and 3) are more relevant to the structure of CIS user price.

**4.21** There are three elements to this pricing principle to which Pay.UK should have regard in setting CIS user prices:

- The CIS contract must be priced efficiently – efficiency of CIS user prices is, to a large degree, determined by the value of the CIS contract negotiated through the procurement. In July, we decided that the obligations on Pay.UK to carry out a competitive procurement will remain – see CP21/8.



- Pay.UK's cost of delivering and managing the NPA must be efficient – as this is another material element of CIS user prices, we want Pay.UK to be transparent about its own costs and to ensure that only the efficiently incurred costs feed into CIS user prices.
- Only costs relevant to the provision of the NPA CIS should be included in CIS user prices – to follow the cost causation principle would mean that costs of other payment systems (such as Bacs and Faster Payments) should not be included in NPA CIS user prices.<sup>17</sup>

## Pricing principle 2 (CIS user prices incentivise utilisation of the NPA)

### Respondents' views

**4.22** Respondents that commented on this pricing principle mainly focused their comments on two aspects of using CIS user prices to incentivise utilisation of the NPA:

- **Use of CIS user prices to incentivise migration to the NPA from Faster Payments and Bacs.** A small percentage of respondents, including a smaller PSP and a technology services provider, said that the NPA should be priced attractively relative to other payment systems from the outset to incentivise migration of transactions to the NPA. Around a third of respondents that commented on this principle, including UK Finance, a number of large PSPs and a large end user, cautioned against using pricing as an incentive to migrate transactions from Bacs and Faster Payments. The respondents warned that participants who are not able to migrate quickly would bear the higher per transaction cost of Bacs and Faster Payments infrastructure – as the fixed costs of Bacs and Faster Payments would be recovered from a smaller number of transactions over time. These respondents thought that those who could not migrate quickly should not be penalised with higher costs of those systems. UK Finance said that the issue of using pricing to incentivise migration is complex and that we should remain mindful of the potentially anti-competitive impact that it may have on the market – such as the potential for regulatory mandates to inadvertently give cost advantages to some parties over others.
- **Use of volume discounts to incentivise utilisation of the NPA.** Three large PSPs suggested that tiered CIS user prices – with lower CIS user prices applying to larger volumes of transactions – could incentivise greater utilisation of the NPA. A consultancy and a large PSP, however, cautioned against the use of volume discounts to safeguard participants with low numbers of transactions.

**4.23** One payment system operator said that the proposed pricing principle may lead to pricing decisions that distort the level playing field between interbank and other payment systems.

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<sup>17</sup> The requirement relates to CIS user pricing and not pricing for Bacs or Faster Payments.

## Our response

- 4.24** Our view remains that CIS user pricing can be an important tool for incentivising utilisation of the NPA. CIS user prices will affect the incentives on PSPs to migrate transactions from Faster Payments and Bacs to the NPA and support innovations by other parties (such as market overlay providers), which might themselves generate additional transactions and improved services. Therefore, our second pricing principle is that CIS user prices should incentivise utilisation of the NPA.
- 4.25** The incentives to utilise the NPA will depend on both the level and structure of CIS user prices. We want Pay.UK to consider how these can be used to optimise utilisation of the NPA. In doing so, Pay.UK would be acting in accordance with the same incentives as any commercial operator of a payment system.
- 4.26** We do not consider that this pricing principle will lead to Pay.UK taking pricing decisions that distort the level playing field between interbank and other payment systems. To the extent this is a concern about competition law, we note that all of the principles, in their application, can (and must) be read consistently with competition law obligations.
- 4.27** Feedback from the consultation raised several issues that Pay.UK should consider in developing its CIS user pricing methodology. These include:
- **Incentives to migrate transactions from Faster Payments and Bacs.** Pay.UK should consider whether, and if so how, CIS user prices can be used to incentivise Faster Payments and Bacs participants to migrate transactions to the NPA including:
    - **Profile of cost recovery** – whether the CIS user prices should be set low initially with build costs recovered once NPA volumes have increased sufficiently.
    - **Prices for different types of transactions** – whether CIS user prices should be set differently for different types of transactions. Differential pricing could help ensure optimal utilisation of CIS capacity. This could help to even out the demand between peak and off-peak time. Differential pricing may also help incentivise migration from Bacs and Faster Payments by offering CIS user prices similar to the prices applicable to Bacs and Faster Payments transaction types with broadly similar features.
    - **Tiered pricing based on volumes of transactions.** Pay.UK should consider the advantages and disadvantages of introducing volume-based tiered pricing to incentivise increased utilisation of the NPA. Tiered pricing could involve volume discounts to PSPs with large transaction volumes, which may give direct PSPs an incentive to compete for indirect PSPs (to increase their volumes on the CIS) leading to lower indirect access prices. Alternatively, tiered pricing could involve offering reduced CIS user prices to smaller PSPs to help them expand and to incentivise them to innovate on the NPA.
    - **Ad valorem pricing.** As we set out in our proposed strategy, one of our priorities is to support and develop interbank payment systems to provide greater competition in retail payments. CIS user pricing can help realise

this priority. Pay.UK should consider whether ad valorem pricing for low value transactions is necessary for the NPA to become a more viable way of paying for goods and services. This would include considering the benefits of such pricing (such as increased use of interbank payments to pay for goods and services) against the costs (including the additional costs of implementing and administering such a pricing model).

### Pricing principle 3 (CIS user prices do not distort competition in end user services)

#### Respondents' views

- 4.28** All respondents that commented on this principle were supportive of equal or fair CIS user pricing to ensure a level playing field for all CIS users.
- 4.29** Some respondents, including two large PSPs, a smaller PSP, a large end user and the EMA, cautioned against interpreting this principle to mean that direct and indirect PSPs would pay the same price. These respondents said that pricing should reflect the risk and responsibilities that participants take on in the payments chain, such that it provides commercial incentives for direct PSPs to provide indirect access.
- 4.30** One large PSP said that the NPA could be processing different types of transactions and these could reasonably have different prices attached to them. The principle that everyone pays the same is valid, but each transaction type could carry a different fee.
- 4.31** One payment system operator suggested amending the wording of the principle to 'foster sustainable and effective competition in end user services'. The respondent said that such a change would place the emphasis on fostering competition where it has a benefit for end users, as opposed to competition for its own sake, in line with our own duties. The respondent said that this was a common distinction made by regulatory and competition authorities, including the Financial Conduct Authority.

#### Our response

- 4.32** We remain of the view that CIS user prices must ensure a level playing field for CIS users and that the implementation of this principle will be an important part of ensuring that.
- 4.33** This, however, does not mean that different transaction types should be priced the same. For example, different transaction types could be priced differently due to:
- differences in underlying costs (this may include costs relating to the consumption of system resources and whether this occurs during peak or off-peak times of day)
  - the competitive conditions
  - the need to recover fixed and sunk costs in the least distorting way

- 4.34** This principle also does not imply that the price of a service needs to be the same for direct and indirect PSPs. CIS user prices charged to direct PSPs can be different from the access price for indirect PSPs because, for example, of the different services being provided.
- 4.35** We note a potential overlap between the requirement of this pricing principle and requirements of GD2, which applies to operators of certain payment systems. Insofar as there is an overlap, nothing in this – or other – pricing principles should be interpreted as releasing Pay.UK from the requirements of GD2 (which require, in particular, operators of certain payment systems to have access requirements that are POND).
- 4.36** We have amended the wording of the principle so that it requires CIS user prices to ‘not distort’ rather than ‘foster’ competition to more accurately reflect our expectations of Pay.UK in setting the CIS user price methodology. We also considered whether we need to add ‘sustainable and effective’ in front of ‘competition in end user services’. We consider that the need for competition to be sustainable and effective is implicit, and we do not consider that stating this explicitly would add to the clarity of the principle.

## Pricing principle 4 (CIS user prices are transparent and predictable)

### Respondents' views

- 4.37** There was widespread support for transparency from all respondents that commented on this pricing principle.
- 4.38** A large user said that Pay.UK should be mandated to publish CIS user prices to ensure transparency. The EMA supported our proposal for Pay.UK to publish the CIS user pricing methodology. One large PSP supported more detailed itemisation of invoices. One smaller PSP said that transparency will help ensure fair pricing for indirect PSPs, which in turn will help innovation and competition.
- 4.39** UK Finance said that Pay.UK already had robust pricing processes in place for Bacs and Faster Payments, and questioned whether it would be beneficial for us to introduce regulation in this regard.
- 4.40** One large PSP suggested that we consider whether publishing CIS user prices could give rise to any unintended consequences – for example, whether it would give other payment systems (such as card payment systems) an advantage if the same transparency requirements do not apply.

## Our response

- 4.41** We remain of the view that transparent and predictable CIS user pricing is important for ensuring a level playing field between NPA participants and incentivising utilisation of the NPA. In particular, it is important that new entrants can understand current and future pricing if they are to invest in new products and services.
- 4.42** If CIS user prices are competitive, then publishing them in the first instance is likely to stimulate price competition with other payment systems, which could lead to a lower cost of payments to end users. We will keep this under review. For now, we consider that benefits of greater transparency for NPA participants would outweigh any potential downsides of other payment systems having sight of CIS user pricing.
- 4.43** To ensure that CIS user prices are transparent and predictable, Pay.UK should, at a minimum:
- publish and engage with a variety of stakeholders on the methodology for setting CIS user prices
  - publish its CIS user pricing schedule, for both mandatory services and any additional optional services offered
  - notify us and participants of material changes to the pricing schedule in advance of implementing any such changes
  - make available the information on the costs of becoming a direct PSP or a market overlay provider<sup>18</sup> and the approved/supported options available for utilising the CIS
  - ensure that invoicing is transparent and easily reconcilable for users
- 4.44** In considering whether to object to Pay.UK's proposed CIS user pricing methodology (see paragraph 4.53), we will take into account whether Pay.UK has adequately engaged on it with stakeholders.

## Pricing principle 5 (CIS user prices adapt to changes in market conditions, including CIS provider costs and competition)

### Respondents' views

- 4.45** All respondents that commented on this pricing principle agreed that CIS user pricing should be flexible and that Pay.UK should be able to vary it over time. In particular, two large PSPs commented that CIS user prices need to be agile to pass on cost savings that the respondents expect to be realised over time from more efficient running of the NPA.

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<sup>18</sup> As far as reasonably possible, given that the costs of becoming a market overlay provider may not be known from the outset.

- 4.46** One large PSP proposed changing the pricing principle to say that CIS user pricing should ‘adapt to changing competitive conditions and benefits from cost reductions through introduction of new technologies such as cloud hosting’. Another large PSP proposed a new pricing principle to require that ‘cost should reduce over time’ – as operational familiarity with NPA CIS increases and supplier return-on-investment is achieved.
- 4.47** Several respondents, including a large PSP and a smaller PSP, highlighted that any flexibility needs to be balanced with price stability, and one smaller PSP said that PSPs should be given notice ahead of prices being changed.

### **Our response**

- 4.48** Our view remains that Pay.UK should consider adjusting the structure and level of CIS user prices in response to changing market conditions, to achieve outcomes in line with its strategic objectives.
- 4.49** We agree with respondents that pricing levels and structure may need to be revised to respond to developments beyond changes in competition. For example, to reflect changes in the underlying costs. Therefore, we changed the wording of the principle from ‘adapt to changing competitive conditions’ to ‘adapt to changes in market conditions, including CIS provider costs and competition’. We would at a minimum want Pay.UK to make a cost/benefit assessment of using an alternative pricing model if market conditions, including CIS provider costs and competition, change.
- 4.50** We are not requiring CIS costs to reduce over time. This is because it is important for Pay.UK to maintain flexibility over the profile of cost recovery. This is so it can set CIS user prices that incentivise utilisation of the NPA and are responsive to changes in market conditions over time.

## **Implementation and monitoring of pricing principles**

- 4.51** Three respondents, including UK Finance and two large PSPs, said that they broadly supported publication of the pricing principles. They also said that any greater enforcement by us beyond this – such as the need for us to approve Pay.UK’s funding and pricing models – would hinder rather than assist Pay.UK in achieving the outcome of a resilient, competitive, efficient and accessible NPA ecosystem.
- 4.52** Our approach to CIS user pricing is outcome focused. We see Pay.UK as having a lead role in developing the CIS user price methodology without prescriptive directions from us.

- 4.53** At the same time, we see CIS user pricing as important for ensuring a competitive NPA ecosystem (see paragraph 4.4). For this reason, we consider that it is important for us to oversee CIS user pricing via a requirement on Pay.UK to set CIS user prices using a methodology that has regard to the pricing principles and does not implement this methodology or make material changes to it until we issue a non-objection statement. As part of the non-objection process, Pay.UK must demonstrate how its methodology has regard to the pricing principles.
- 4.54** In addition, we intend to require Pay.UK to report certain data to us annually to allow us to monitor the impact of CIS user prices on NPA participation (including new entrants). We will provide further information on the reporting requirements in due course.
- 4.55** Alongside the formal non-objection process set out in the direction, we will have regular engagement with Pay.UK to provide timely feedback on options that are being considered by Pay.UK during development of the CIS user pricing methodology.

# 5 The role of a CIS provider

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If a CIS provider (or an affiliate) has a significant interest in another payment system or in overlay services, its CIS functions must be operationally separate from other parts of its (or an affiliate's) business.

A CIS provider that is subject to this requirement must demonstrate that the operational separation implemented adheres to the following principles:

- In providing CIS, a CIS provider does not unduly discriminate between participants and does not act in a way that gives other parts of its or an affiliate's business an unfair commercial advantage.
- Information received or derived by a CIS provider from providing CIS is not disclosed to or used by other parts of its or an affiliate's business.
- Provision of CIS is not unduly influenced by a CIS provider's or an affiliate's interest in providing services other than CIS.

Effective arrangements must also be put in place to ensure compliance by a CIS provider and other parts of its or an affiliates' business with the obligations to operationally separate.

A CIS provider's proposals for its detailed implementation and monitoring of operational separation will be subject to our non-objection. Any updated versions that may be produced or required over time will also be subject to our non-objection. The provider will be required to monitor and report on its compliance.

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## Introduction

**5.1** In CP21/2, we proposed that if a CIS provider (or its owner) has a significant interest in another payment system that competes with interbank payments or in the NPA's overlay markets, its CIS functions must be operationally separate from other parts of its (or its owner's) business.

**5.2** We also said in CP21/2 that we would need to consider the exact boundaries of any separation further but we were of the view that at a minimum there may be a need for:

- distinct branding between a CIS provider's CIS activities and its (or its owner's) overlay services
- separate accounting and business processes
- information firewalls to prevent a CIS provider sharing information with other parts of its (or its owner's) business



- 5.3** We have decided that a CIS provider should operationally separate its CIS functions from other parts of its (or an affiliate's) business if it (or an affiliate) has a significant interest in another payment system or in overlay services. We will require that a CIS provider must demonstrate that operational separation (by which we mean separation of the type indicated by paragraph 5.23 below) meets certain outcomes (as set out in Box 5 below). In the remainder of this chapter, we summarise and respond to the comments we received on this topic.

## Operational separation requirements

### Respondents' views

- 5.4** Respondents expressed broad support for the principle of imposing operational separation on a CIS provider if it (or its owner) has a significant interest in another payment system that competes with interbank payments or in the NPA's competitive overlay markets. Those respondents that gave reasons for this view said that operational separation would be beneficial to transparent operation of the system and reduce a CIS provider's ability and incentive to engage in activities that distort competition. They also said that operational separation from other payment systems would be essential for reasons of resilience and continuity of service.
- 5.5** One consultancy said that structural separation (into entirely unrelated entities) should be preferred to operational separation to mitigate the risks identified in CP21/2, although there were no specific reasons given to explain why operational separation would be inadequate. The British Retail Consortium asked us to consider if structural separation should be preferred. On the other hand, some respondents of all types said they did not support structural separation. The most common disadvantages cited by such respondents were potential impacts on the resilience of CIS provision or on a CIS provider's ability to leverage expertise, knowledge, infrastructure or capabilities within its wider corporate group – especially in order to deliver innovation or economies of scale or scope.
- 5.6** 25 respondents answered question 11 in CP21/2, which asked for views on the elements of operational separation that should be introduced. Some respondents, mainly PSPs and trade associations, said that the elements required would depend on the specific identity and characteristics of the CIS provider(s) chosen and that their views on question 11 would vary accordingly. A few respondents said any operational separation requirements should be flexible over time, for example because a CIS provider's relevant circumstances (or those of its wider corporate group) might change due to mergers and acquisitions or other reasons.
- 5.7** Around two-thirds of all respondents commented on one or more specific elements of operational separation that they thought could be required. Many of these respondents identified some or all of the elements we identified. Very few, however, provided specific reasons or examples as to why individual elements would be important.

- 5.8** Most of the respondents that commented on specific elements of operational separation indicated information firewalls as being either the most important, or a significant, element.
- 5.9** Most respondents also said separated accounts should be required for any CIS provider(s). A few said this would improve transparency and a few referred to the need to monitor potential cross-subsidisation between a CIS provider and its wider corporate group. Most also suggested there should be separation of business processes including governance processes. A few respondents also proposed separation of personnel, offices and/or IT systems, and distinct branding. On branding, a few respondents argued this was unnecessary, especially because the (potential) customers of any overlay providers would be business customers rather than individual consumers. Two other potential elements, namely an employees' code of conduct and remuneration principles, were proposed by one respondent each.
- 5.10** Some respondents said that we should consider the proportionality of the operational separation requirements that might be placed on a CIS provider so as not to affect disproportionately any provider's ability to operate efficiently. A few also said that there would be a need for ongoing monitoring of compliance.

## Our response

- 5.11** We have decided that a CIS provider should operationally separate its CIS functions from other parts of its (or an affiliate's) business if it (or an affiliate) has a significant interest in another payment system or in overlay services. We will require that any such CIS provider must demonstrate that the operational separation it implements meets the outcomes set out in Box 5. Effective arrangements must also be put in place to ensure compliance by a CIS provider and other parts of its or (an affiliate's) business with the obligation to operationally separate.
- 5.12** Such an outcome-focused measure is more appropriate than setting prescriptive rules regarding specific elements of operational separation. It will allow for the exact form of operational separation to be developed (via the implementation processes set out in paragraphs 5.29 to 5.32) in the most appropriate way in the specific circumstances of each relevant CIS provider at the time. Our views on the elements of operational separation that we expect will generally be needed are set out in paragraph 5.23.

### **Box 5: Outcomes of operational separation**

- In providing CIS, a CIS provider does not unduly discriminate between participants and does not act in a way that gives other parts of its or an affiliate's business an unfair commercial advantage.
- Information received or derived by a CIS provider from providing CIS is not disclosed to or used by other parts of its or an affiliate's business.
- Provision of CIS is not unduly influenced by a CIS provider's or an affiliate's interest in providing services other than CIS.

**5.13** The required outcomes in Box 5 are intermediate outcomes, the achievement of which will ultimately contribute to ensuring the benefits of effective competition and innovation. The required outcomes are derived directly from the horizontal and vertical risks that are summarised in Chapter 2. We have specified the outcomes so as to provide, when taken together, a complete coverage of the potential mitigation of these risks that might be achieved by operational separation. Specifically, this operational separation will, by requiring the outcomes set out in Box 5, help to ensure the mitigation of the following horizontal and vertical risks:

- that a CIS provider with a significant interest (directly or through an affiliate) in another payment system takes decisions that benefit that payment system to the detriment of the NPA or reduce competition between payment systems
- that a CIS provider with a significant interest (directly or through an affiliate) in overlay services takes decisions that discriminate against other overlay providers
- that a CIS provider with a significant interest (directly or through an affiliate) in another payment system exploits information and data it has access to as a CIS provider to give an unfair advantage to that other payment system
- that a CIS provider with a significant interest (directly or through an affiliate) in overlay services causes them to gain an unfair advantage over the services of other overlay providers by exploiting information and data it has access to as a CIS provider
- that a CIS provider with a significant interest (directly or through an affiliate) in another payment system seeks to benefit that payment system by delaying or preventing innovation in the NPA
- that a CIS provider with a significant interest (directly or through an affiliate) in overlay services seeks to delay or prevent innovation in CIS that would benefit other overlay providers
- that a CIS provider shares with other parts of its business or affiliates that provide overlay services information on plans by new entrants to provide new innovative services or data that it gathers as part of its operations that is not available to possible competitors
- that a CIS provider shares commercially sensitive information (or information only it has access to) with other parts of its business or affiliates in another payment system, thus distorting competition between systems

**5.14** Our operational separation requirements will be imposed on any relevant CIS provider(s). When combined with the requirements on Pay.UK (see Chapters 3 and 4), this will further reduce the ability and incentive for any such CIS provider to act in a way that distorts competition or limits innovation. The operational separation requirements will, therefore, contribute to the benefits of our regulatory framework by promoting competition and innovation in payment services and between payment systems. This primary effect of our operational separation requirements will arise because they will confirm to a relevant CIS provider that it must take actions, both while preparing to provide CIS and then while doing so, to ensure that the required outcomes are achieved.

- 5.15** The giving of a direction to a CIS provider will also have further effects in that it will: formalise our ability to monitor the provider's compliance in pursuit of our desired outcomes; emphasise the importance of such compliance to the provider's directors and employees; and provide confirmation to, for example, CIS users and (potential) innovators regarding the details and relevance of our regulatory framework.
- 5.16** The requirements to be placed on Pay.UK can also be expected to lead, via Pay.UK's contract(s) and relationship(s) with any CIS provider(s), to confirmation that the provider(s) must take actions (regarding, for example, the confidentiality of information). It will only, however, be because of our additional, complementary direct regulation of any relevant CIS provider(s) that the full effects noted above in paragraphs 5.14 and 5.15 will be realised. Our direct regulatory oversight will, in particular, allow us to ensure (via the non-objection and other processes set out in paragraphs 5.29 to 5.32 and in our illustrative directions) that the operational separation arrangements proposed and then maintained by a relevant CIS provider are suitable to achieve all the required outcomes.
- 5.17** We remain of the view that structural separation should not, in principle, be required if operational separation is implemented effectively. By structural separation, we mean that the owner of a CIS provider that meets our significant interest criteria would have to divest either its interest in the CIS provider or the relevant significant interest(s). Structural separation would also mean that the owner of a CIS provider that does not initially meet our significant interest criteria could not subsequently acquire such a significant interest.
- 5.18** In our view, operational separation (if required) is effective because any relevant CIS provider will be required to achieve the outcomes specified in Box 5 above and these outcomes would mitigate the risks listed at paragraph 5.13 above. These outcomes would be achieved by a CIS provider, both initially and on an ongoing basis<sup>19</sup>, via the combined implementation, non-objection, monitoring and compliance processes set out in paragraphs 5.29 to 5.32 of this chapter.
- 5.19** Operational separation would also be implemented in the context of both our technical design principles that Pay.UK should follow and the requirements on Pay.UK set out in Chapters 3 and 4. In this context, the outcomes, elements and implementation and other processes of operational separation set out in this chapter and our illustrative directions will provide the necessary basis for any separation implemented by a relevant CIS provider to address the risks we have identified. The combined outcomes and elements will cover all the risks listed above in paragraph 5.13 and the implementation and other processes are designed to ensure that the outcomes will be achieved.

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19 Including if, for example, remedial action is required further to breaches of operational separation arrangements.

**5.20** Taken together, therefore, we expect the full regulatory framework to mitigate the horizontal and vertical risks (as detailed in CP21/2 and in Chapter 3 above) that are associated with CIS provision. Any residual risk that this mitigation might not be effective could only be removed by structural separation, which would be a more intrusive remedy but one that in our view is not necessary at this time for the reasons set out in paragraph 5.18.<sup>20</sup> Furthermore, we have not received evidence to suggest that it is necessary.

**5.21** We could, however, consider returning to structural separation in the future if residual risk concerns were to arise regarding new services or actions or omissions by a relevant CIS provider or its affiliates. With regard to new services, this could be, for example, if the CSS provider were also to be chosen (or under consideration) by Pay.UK to provide common services that would lead to competition risks of sufficient concern.<sup>21</sup> Before resorting to structural separation, however, we would consider whether different operational separation arrangements would be appropriate.

### Elements of operational separation

**5.22** The elements of operational separation required to comply with our requirement will depend on all the circumstances that exist at the time. Any operational separation that a CIS provider must implement will be confirmed in light of factors such as the nature and scope of CIS to be provided (for example, whether it will provide the CSS, one or more specific common services, or both), the types of any commercially sensitive information or data a CIS provider will have access to as part of providing its services, and the ability of a CIS provider to share that information with other parts of its (or an affiliate's) business. We intend to discuss detailed operational separation arrangements with any relevant CIS provider as soon as possible and well in advance of any CIS contract being signed.

**5.23** Achievement of the outcomes set out in Box 5 will be the requirement that must be met by a CIS provider, as specified in the relevant illustrative direction published alongside this document. For this to be achieved, we would expect that the operational separation applied by any relevant CIS provider will generally need to include the nine elements listed below and to be actively implemented and monitored so as to achieve the required outcomes. As set out in paragraph 5.29, we will engage with any CIS provider to discuss these elements, how they might be implemented in its specific circumstances and any alternative listing or implementation of elements that a CIS provider might propose would achieve our required outcomes. For the avoidance of doubt, the separation required is as between, on one side, an entity whose activities include the provision of NPA CIS and, on the other side, the sources of that entity's or an affiliate's significant interests as defined in Box 3 in Chapter 3 above.

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20 It could also introduce additional risks or costs related to a CIS provider's ability to benefit legitimately from the experience and capabilities of other parts of its or its owner's business.

21 For the avoidance of doubt, our views set out in this chapter apply to our current understanding of the CIS (that is, CSS and common services) in keeping with the current design for the NPA (see paragraphs 2.8 and 2.9 and Annex 1 of this document). These views would not necessarily apply to any issues that could arise in the potentially competitive markets for the overlay services in that design (for example, if market power were to become an issue in one or more such markets due to network effects or other reasons).

- **Element 1:** Information firewalls preventing the flow of any information received or derived from providing CIS, with any classes of exceptions to be identified by the CIS provider and subject to our non-objection as part of the implementation processes described in paragraphs 5.31 and 5.32 below.
- **Element 2:** Separated office spaces, with access controls to prevent access by personnel from other parts of the CIS provider's or an affiliate's business.
- **Element 3:** Distinct IT systems, with access controls to prevent employees from other parts of the CIS provider's or an affiliate's business from accessing CIS information.
- **Element 4:** A separate workforce (all employees and contractors), with specified minimum 'gap' periods for any individuals moving between the CIS provider and other parts of its or an affiliate's business.
- **Element 5:** An employee code of conduct (regarding how staff will comply with all relevant operational separation requirements), which should apply to the CIS provider's entire workforce (who should receive appropriate training regarding the applicability of the requirements to their work and sign a specific confidentiality statement), and which should also be communicated appropriately to at least all UK-based employees of other parts of the CIS provider's (or an affiliate's) business.
- **Element 6:** Distinct branding as between the CIS provider and the businesses that are the sources of its or an affiliate's significant interests.
- **Element 7:** An independent Board for the CIS provider entity.
- **Element 8:** The remuneration of all CIS provider personnel to be unrelated to the performance of the businesses that are the source of its or an affiliate's significant interests.
- **Element 9:** Named individuals or role holders in the CIS provider to be responsible for operational separation and its related monitoring and reporting.

**5.24** As regards the distinct branding element, our view remains that there is a risk of a CIS provider or other parts of its or an affiliate's business creating an impression that an overlay service is part of CIS or otherwise leveraging their CIS brand(s) to the benefit of an overlay service. Distinct branding might also help to allay concerns, particularly on the part of potential new entrants, that information might cross the information firewalls that should prevent it from reaching their potential competitors in other parts of a CIS provider's or an affiliate's business. Distinct branding could, therefore, be an important element of operational separation.

**5.25** In CP21/2, we said that operational separation could include accounting separation, which would allow Pay.UK, the PSR and other participants to monitor how closely prices for CIS reflect the underlying costs of that activity. As set out in Chapter 3, however, Pay.UK will be required to set CIS user prices, which removes the ability for a CIS provider to engage in price discrimination and hence one reason for accounting separation. In addition, monitoring Pay.UK's compliance with our pricing principles

(see Chapter 4) may not require any monitoring of a CIS provider's pricing and profitability. Moreover, Pay.UK's procurement processes and contracts for CIS will likely take account, for Pay.UK's own purposes, of both transparency and monitoring of costs. If issues or circumstances arise in the future that require us to request information from a CIS provider regarding its costs and margins, we would request such information as part of our ongoing monitoring at that time.

- 5.26** Elements 2 to 6 in paragraph 5.23 are primarily intended to directly reinforce element 1, which is key to mitigating the vertical and horizontal competition risks identified in paragraph 3.47. Together, these elements would help to ensure both that information received or derived by a CIS provider is protected and that a CIS provider's directors and employees are prevented from acting contrary to the required outcomes.
- 5.27** Elements 7 to 9 are further common features of operational separation arrangements, which in this case would be intended to ensure additional incentives and governance to not behave in ways that distort competition (for example, by unduly discriminating between participants) or stifle innovation.<sup>22</sup> Specifically, these latter elements would help to ensure that directors and employees face strong incentives and governance both to act independently of any significant interest(s) in other payment systems or in overlay services and, more generally, to comply with our direction. Given the risks associated with a CIS provider or an affiliate having such significant interests, we would expect such incentives and governance to be needed in all cases in order for the required outcomes to be achieved by such a CIS provider.
- 5.28** All of the elements of operational separation would be expected to contribute to the confidence of, for example, new entrants that they can enter overlay markets and compete fairly.

## Monitoring and implementation of operational separation

- 5.29** As set out in paragraph 5.22, we intend to discuss detailed operational separation arrangements with any relevant CIS provider as soon as possible and well in advance of any CIS contract being signed. As part of that process, we will seek to establish whether bidders for CIS will be expected to meet either of the criteria for requiring operational separation (that is, a significant interest in another payment system or in overlay services). If so, in parallel with any CIS procurement process, we would engage with relevant potential CIS providers to understand their proposals for operational separation (including by requesting a draft compliance statement) and to make clear our expectations. Through such engagement, we would expect to discuss the elements of operational separation listed in paragraph 5.23, how they might be implemented in any CIS provider's specific circumstances and any alternative listing or implementation of elements that a CIS provider might propose would achieve our required outcomes.

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<sup>22</sup> All the operational separation elements listed in paragraph 5.23 are as used, for example, on a case-by-case basis by other regulators such as Ofcom, Ofgem, Ofwat, the Financial Reporting Council and the European Commission.



- 5.30** Operational separation would also become required if a CIS provider that did not initially meet either of the criteria subsequently had a change in circumstances (for example, because of a merger between it (or an affiliate) and an overlay provider).
- 5.31** If a CIS provider meets either of the criteria for operational separation, we would issue a direction that would include a requirement to submit to us:
- an initial compliance statement setting out its proposals for detailed implementation and monitoring<sup>23</sup> of our separation requirements, supported by any policy, 'handbook' and relevant internal guidance documents that it intends to issue
  - an annual compliance report setting out its ongoing compliance with the separation requirements, including any compliance breaches and the remedial actions taken and planned
- 5.32** All such documents must be approved by the CIS provider entity's Board before submission to us. Any initial compliance statement including policy and 'handbook' documents (including any updated versions that may be produced over time)<sup>24</sup> would also be subject to our non-objection and non-confidential versions would be published by the CIS provider(s). The CIS provider(s) would also be required to publish non-confidential versions of their (annual) compliance reports.
- 5.33** Where a CIS provider (or an affiliate) does not have a significant interest in another payment system or in overlay services, it must notify us if this might change due to any proposed action or change in circumstances and in any event report annually on its position.

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23 Including its processes for identifying and/or addressing any (potential) breaches or complaints.

24 Such updated versions as might be proposed periodically by a CIS provider could be prepared and proposed by that CIS provider either at its own instigation or at ours. On our part, this could be further to, for example: our own monitoring or investigations; information or complaints received from third parties; or some other evidence-based and proportionate reasoning.



# 6 Why we are introducing our regulatory framework

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Our regulatory framework for NPA CIS is an effective and proportionate way to prevent, or reduce the likelihood of, a CIS provider acting in ways that distort competition or stifle innovation to the detriment of people and businesses

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**6.1** Our objective in implementing the regulatory framework is to address three sets of risks to competition and innovation in the NPA ecosystem, which could arise from a CIS provider's behaviour:

- **Monopoly risks.** A CIS provider might not have strong incentives to control costs and margins or improve services, leading to higher CIS user prices and inferior service quality for CIS users.
- **Horizontal competition risks.** If a CIS provider (or an affiliate) has a significant interest in another payment system, it could try to give an unfair advantage to that payment system to the detriment of the NPA.
- **Vertical competition risks.** If a CIS provider (or an affiliate) has a significant interest in overlay services, it could have an unfair advantage over other providers of similar services.

**6.2** If these risks materialise, competition in payment services or between payment systems could be distorted or dampened, leading to higher prices, lower quality of service and less innovation. The scale of the harm could be significant. Our economy and society depend on interbank payments. Bacs and Faster Payments, which the NPA is intended to replace, accounted for nearly £7 trillion of payments in 2020 and are used by millions of us every day to pay bills or transfer money to a friend. In the future, interbank payments could also be used more often to pay for our shopping and in new use cases, leading to more choice and better value for people and businesses from stronger competition between payment systems.

## How the regulatory framework will work

- 6.3** Our regulatory framework places requirements on Pay.UK (irrespective of who provides CIS) and a CIS provider.

### Requirements on Pay.UK

- 6.4** The requirements on Pay.UK and why we are making them are summarised in Table 2. We explained these in more detail in Chapters 3 and 4.

**Table 2: Requirements on Pay.UK**

| Requirement  | What risks does the requirement address?   | How does the requirement address the risks?   |
|--|--|---|
| <b>Pay.UK must be the primary interface and decision-maker for CIS provision</b> | There is a <b>monopoly risk</b> that a CIS provider develops a significant incumbency advantage for any future procurement exercises (see paragraph 3.11).   | The requirement will help ensure that Pay.UK builds and maintains sufficient expertise and capability to: a) avoid a CIS provider influencing the structure and requirements for future procurement exercises; and b) manage potential migration to different providers over time effectively.<br><br>This will in turn help ensure that all bidders in any future procurement exercise compete on a level playing field. |
|  | As set out in paragraph 3.12, if a CIS provider (or an affiliate) has a significant interest in another payment system, there is a <b>horizontal competition risk</b> that it will: <ul style="list-style-type: none"> <li>take decisions about CIS that benefit another payment system or reduce competition between payment systems</li> <li>exploit information and data it has access to as a CIS provider to give an unfair advantage to that payment system</li> </ul> | The requirement reserves some decisions about CIS to Pay.UK and only permits Pay.UK to let a CIS provider take other decisions about CIS where certain conditions are met, thereby reducing the ability of a CIS provider to take decisions that benefit another payment system in which it (or an affiliate) has a significant interest.   |

| Requirement | What risks does the requirement address?   | How does the requirement address the risks?   |
|-------------|--|---|
|             |  | <p>The requirement only permits Pay.UK to let a CIS provider interact with new and existing participants where certain conditions are met. This reduces the information a CIS provider receives in the course of providing CIS and hence its ability to exploit such information to give an unfair advantage to another payment system in which it (or an affiliate) has a significant interest.</p>  |
|             | <p>As set out in paragraph 3.13, if a CIS provider (or an affiliate) has a significant interest in overlay services, there is a <b>vertical competition risk</b> that it will:</p> <ul style="list-style-type: none"> <li>• take decisions about CIS that benefit its overlay services or discriminate against other overlay providers</li> <li>• exploit information and data it has access to as a CIS provider to give an unfair advantage to its overlay services</li> </ul> | <p>The requirement reserves some decisions about CIS to Pay.UK and only permits Pay.UK to let a CIS provider take other decisions about CIS where certain conditions are met, thereby reducing the ability of a CIS provider to take decisions that benefit overlay services in which it (or an affiliate) has a significant interest.</p> <p>The requirement only permits Pay.UK to let a CIS provider interact with new and existing participants where certain conditions are met, thereby reducing the information a CIS provider receives in the course of providing CIS and hence its ability to exploit such information to give an unfair advantage to overlay services in which it (or an affiliate) has a significant interest.</p> |
|             | <p>There is a <b>monopoly risk</b> that a CIS provider sets CIS user prices that maximise its profit to the detriment of service-users (see paragraph 3.25).</p>   | <p>The requirement removes the ability of a CIS provider to set CIS user prices by mandating that Pay.UK carries out this function.</p>   |

| Requirement   | What risks does the requirement address?   | How does the requirement address the risks?  |
|---|--|--|
| <b>Pay.UK must set CIS user prices, and do so using a methodology that has regard to certain pricing principles and is subject to our non-objection</b> | <p>If a CIS provider (or an affiliate) has a significant interest in another payment system, there is a <b>horizontal competition risk</b> that it will set CIS user prices that give an unfair advantage to that payment system (see paragraph 3.25).</p>   |  |
|   | <p>If a CIS provider (or an affiliate) has a significant interest in overlay services, there is a <b>vertical competition risk</b> that it will engage in price discrimination against other overlay providers (see paragraph 3.25).</p>   |  |
| <b>Pay.UK must set the rules and standards for NPA CIS and ensure that these facilitate competition and innovation</b>                                  | <p>As described in paragraph 3.32, there are <b>monopoly risks</b> that a CIS provider could seek to set or influence rules and standards for the NPA CIS to</p> <ul style="list-style-type: none"> <li>• increase its profits for example via reduced service quality</li> <li>• build up an incumbency advantage for future procurement exercises</li> </ul> | <p>The requirement will help ensure that Pay.UK takes ownership of any rules and standards for NPA CIS, meaning that it maintains full awareness and detailed understanding of all rules and standards at all times.</p> <p>This will reduce the ability of a CIS provider to influence any rules and standards in order to increase its profits. It will also help ensure that Pay.UK has sufficient expertise to ensure that an incumbent provider does not influence rules and standards in a way that could give it an incumbency advantage in future procurement exercises.</p> |
|   | <p>If a CIS provider (or an affiliate) has a significant interest in another payment system, there is a <b>horizontal competition risk</b> that it will set CIS rules and standards that give an unfair advantage to another payment system (see paragraph 3.32).</p>  | <p>The requirement removes the ability of a CIS provider to set CIS rules and standards by mandating that Pay.UK carries out this function.</p>  |

| Requirement   | What risks does the requirement address?  | How does the requirement address the risks?  |
|---|---|--|
| <b>Pay.UK must ensure that CIS facilitate innovation and competition.</b> | <p>If a CIS provider (or an affiliate) has a significant interest in overlay services, there is a <b>vertical competition risk</b> that it will set CIS rules and standards that give an unfair advantage to its overlay services (see paragraph 3.32).</p> <p>There is a <b>monopoly risk</b> that a CIS provider does not develop and maintain CIS to facilitate innovation and competition in the NPA ecosystem where this is of no or limited benefit to it, which could negatively affect the degree to which the CIS facilitates innovation in overlay services (see paragraph 3.40).</p> | <p>The requirement reduces the ability and incentive of a CIS provider to delay or prevent innovation in CIS by ensuring Pay.UK takes steps to mitigate this, for example by introducing appropriate SLAs in the CIS contract.</p> |
|   | <p>If a CIS provider (or an affiliate) has a significant interest in another payment system, there is a <b>horizontal competition risk</b> that it seeks to benefit that payment system by not developing and maintaining CIS to facilitate innovation and competition in the NPA ecosystem (see paragraph 3.40).</p>   |  |
|   | <p>If a CIS provider (or an affiliate) has a significant interest in overlay services, there is a <b>vertical competition risk</b> that it delays or prevents changes to CIS that would benefit other overlay providers (see paragraph 3.40).</p>   |  |

| Requirement   | What risks does the requirement address?   | How does the requirement address the risks?  |
|---|--|--|
| <p><b>Pay.UK must:</b></p> <ul style="list-style-type: none"> <li>ensure that a CIS provider does not use, or disclose to any other party, including its affiliates information and data for anything other than CIS provision</li> <li>in a timely manner, make available to the market information and data concerning the provision of CIS that would help facilitate competition or innovation</li> </ul> | <p>If a CIS provider (or an affiliate) has a significant interest in another payment system, there is a <b>horizontal competition risk</b> that a CIS provider shares commercially sensitive information (or information only it has access to) with other parts of its business or affiliates in that payment system (see paragraph 3.47).</p> <hr/> <p>If a CIS provider (or an affiliate) has a significant interest in overlay services, there is a <b>vertical competition risk</b> that a CIS provider shares commercially sensitive information (or information only it has access to) with other parts of its business or affiliates that provide overlay services (see paragraph 3.47).</p> | <p>The requirement reduces the ability and incentive of a CIS provider to disclose commercially sensitive information (or information only it has access to) by ensuring Pay.UK takes steps to mitigate this, for example by introducing appropriate provisions in the CIS contract.</p> |

**6.5** As explained in Chapter 3 and set out in Table 2, we will require Pay.UK to set CIS user prices. The way Pay.UK does this will affect competition and innovation in the NPA ecosystem, including the incentives on parties to use the NPA and their decisions to develop products (such as overlay services) which use the NPA CIS. For this reason, Pay.UK must set CIS user prices using a methodology that has regard to five pricing principles.

**6.6** We consider that Pay.UK can implement our requirements because:

- as the delivery body for the NPA, it will design the rules and standards for CIS and negotiate the terms under which they are provided
- as the intended operator of the NPA, it will manage the CIS contract and administer the rules and standards for these services

**6.7** As described in paragraph 3.60, in the directions that implement our regulatory framework, we intend to require Pay.UK to report to us so we can monitor its compliance with the requirements and, if appropriate, take enforcement action.

## Requirements on a CIS provider

**6.8** Our regulatory framework also places requirements on a CIS provider. The requirement that applies depends on whether or not a CIS provider (or an affiliate) has a significant interest in another payment system or in overlay services:

- if a CIS provider meets one of these criteria, it will be required to operationally separate its CIS functions from other parts of its (or an affiliate's) business
- if a CIS provider does not meet either of these criteria, it will be required to notify us if this might change due to any proposed action or change in circumstances

**6.9** The first requirement reduces the ability and incentives of a CIS provider to distort competition or stifle innovation where it (or an affiliate) has a significant interest in another payment system or in overlay services (see paragraphs 5.13 to 5.19). As explained in paragraph 5.16, where a CIS provider (or an affiliate) has such an interest, the requirements on Pay.UK alone will not be sufficient to address the horizontal and vertical competition risks identified in paragraph 2.10. Hence why we will impose a requirement on a CIS provider to operationally separate its CIS functions from other parts of its (or an affiliate's) business where the criteria requiring this are met. The second requirement ensures that we have the information necessary to determine if one of the criteria is met for the purposes of deciding whether to give a direction requiring operational separation.

**6.10** The requirement to operationally separate can be implemented by a CIS provider with a significant interest in another payment system or in overlay services. Any changes required to the organisation of its business to comply are within its control. We will engage at an early stage with any CIS provider(s) to establish whether they meet one of the criteria requiring operational separation. Moreover, where a CIS provider meets one of these criteria, it will be responsible for bringing forward proposals setting out how it will comply.

**6.11** A CIS provider that does not meet the criteria requiring operational separation can implement the requirement to notify us if this might change. A CIS provider is best placed to know about developments that affect its business and can assess if these would mean it meets the criteria requiring operational separation because we have defined what constitutes a significant interest in another payment system or in overlay services – see Box 3 in Chapter 3.

**6.12** In the direction requiring operational separation, we intend to include reporting requirements on a CIS provider so we can monitor its compliance and, if appropriate, take enforcement action.

## The overall impact of the regulatory framework

- 6.13** The NPA has the potential to strengthen competition in payment services and between payment systems. This will benefit service-users by providing better value and more choice of payment options. It could also help enable PSPs and others to offer innovative payment services and related products that better meet their customers' needs.
- 6.14** As set out in paragraph 2.10 and Annex 2, there are risks to competition and innovation from the behaviour of a CIS provider. If these risks materialise, competition could be distorted or dampened, or innovation stifled, to the detriment of people and businesses and the overall benefits case for the NPA. Our regulatory framework helps address these risks by placing requirements on Pay.UK and a CIS provider.

### The overall (net) benefits of the regulatory framework

- 6.15** **Our regulatory framework introduces new requirements on Pay.UK.** For the reasons explained in Chapters 3 and 4 and summarised in Table 2, these requirements help reduce the ability and incentive of a CIS provider to distort competition and innovation in the NPA ecosystem.
- 6.16** Our regulatory framework creates compliance costs for Pay.UK. For example, it will incur resource costs to implement the requirements and report on its compliance with them. As Pay.UK is a not-for-profit entity that currently operates on a cost-recovery basis, it will pass on these costs to CIS users that in turn may pass on the costs to their customers.
- 6.17** We anticipate these costs will be limited and outweighed by the benefits of our regulatory framework, lowering the risks that a CIS provider behaves in ways that distort competition or stifle innovation. If these risks materialise, there could be significant harm to people and businesses:
- **Harm from monopoly risk.** A CIS provider has incentives to exploit its monopoly position to maximise its profits. If it does so, this could lead to higher prices or lower quality of service for the people and businesses that use interbank payments. It could also strengthen a CIS provider's incumbency advantage in any future procurements, making it harder for those procurements to achieve value for money for service-users.
  - **Harm from horizontal competition risks.** A CIS provider (or an affiliate) that has a significant interest in another payment system could seek to give an unfair advantage to that payment system to the detriment of the NPA, which in turn could dampen or distort competition between payment methods. As set out in our proposed strategy, effective competition between payment methods can help provide better and more affordable services.<sup>25</sup>

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<sup>25</sup> PSR, *Our proposed PSR Strategy* (2021), paragraph 5.68. See: <https://www.psr.org.uk/publications/general/our-proposed-strategy/>



- **Harm from vertical competition risks.** A CIS provider (or an affiliate) with a significant interest in overlay services could have an unfair advantage over other providers of such services. This in turn could dampen or distort competition in overlay services. Effective competition in NPA overlay services can improve payment outcomes for consumers. For example, for several years industry has anticipated that these competitive overlay services can better detect and prevent fraud or make it easier to send and reconcile payment information.

**6.18** Our regulatory framework also gives confidence to potential entrants that a CIS provider (or its affiliates) will not have an unfair advantage in overlay services or will otherwise distort or dampen competition in the NPA ecosystem.

**6.19** Since we consulted on our regulatory framework, we have also removed the standalone requirements proposed in CP21/2 for Pay.UK to run an effective procurement (see paragraph 3.54) and made the proposal that CIS user prices should follow our pricing principles less prescriptive (see paragraph 4.5).

**6.20** **Our regulatory framework introduces requirements on a CIS provider.** The requirements depend on whether or not a CIS provider (or an affiliate) has a significant interest in another payment system or in overlay services (see Box 3 in Chapter 3).

**6.21** If a CIS provider (or an affiliate) has a significant interest in another payment system or in overlay services, it must operationally separate its CIS functions from other parts of its (or its affiliate's) business. As explained in paragraphs 5.13 to 5.19, this helps reduce a CIS provider's ability and incentives to give an unfair advantage to another payment system or its overlay services to the detriment of NPA service-users.

**6.22** Where a CIS provider meets the criteria requiring operational separation, the costs of implementing this will depend on various factors. These include the elements of operational separation that are required (see paragraphs 5.22 and 5.23) and the structure of the CIS provider's organisation and its business processes. If a CIS provider needs to make significant changes to meet the requirement, the costs of implementation could be material. A potential CIS provider with a significant interest in another payment system or in overlay services may factor into its bid the costs of implementing operational separation. Pay.UK will recover the costs of the CIS contract (including any costs of implementing operational separation) from CIS users – see paragraph 6.17.

**6.23** The costs of operational separation are likely to be outweighed by the harm that could be caused if the risks to competition and innovation materialise due to the behaviour of a CIS provider with a significant interest in another payment system or in overlay services (see paragraph 6.17). As explained in paragraph 5.16, where a CIS provider (or an affiliate) has such an interest, the requirements on Pay.UK alone will not be sufficient to address the risks. We will take account of compliance costs when engaging with a CIS provider on the elements of operational separation it will implement to meet our requirement.

- 6.24** If a CIS provider does not meet the specified conditions, it must still notify us if this could change as a result of potential actions or change of circumstances (and in any event report annually on its position). As explained in paragraph 6.9, this ensures we have the information to decide if a direction requiring operational separation should be given.

## Other considerations

- 6.25** We are required to comply with the Public Sector Equality Duty under section 149 of the Equality Act 2010. We do not consider that the regulatory framework set out in this statement, (including as they are reflected in the illustrative directions), will affect the matters we have had regard to in accordance with our duty.

# 7 Next steps

- 7.1** We plan to give directions to Pay.UK and a CIS provider to implement the NPA CIS regulatory framework described in Chapters 3 to 5. Annex 3 sets out three illustrative directions that are examples of how we would implement our regulatory framework:
- one that would require Pay.UK to take specified actions to help lower the risks to competition and innovation and set a methodology for CIS user prices that has regard to certain pricing principles
  - one that would require any CIS provider to operationally separate its CIS functions from other parts of its (or an affiliate's) business where it (or an affiliate) has a significant interest in another payment system or in overlay services
  - one that would require a CIS provider that does not have a significant interest in another payment system or in overlay services to notify us if this might change due to any proposed action or change in circumstances and in any event report annually on its position
- 7.2** FSBRA enables the Treasury to designate payment systems and thereby bring them into the scope of regulation by the PSR. This paper, and the illustrative directions published alongside it, have been developed on the basis of a scenario where the Treasury decides to designate the NPA, or aspects of it, as a regulated payment system. Any potential designation of the NPA will be subject to the procedure for designation established in FSBRA, and is at the discretion of the Treasury.
- 7.3** We are publishing the illustrative directions in Annex 3 to illustrate to stakeholders – particularly Pay.UK and bidders participating in any CIS procurement – how the directions we plan to give to implement our regulatory framework could look. We consider this will assist those parties in their work on the procurement.
- 7.4** We are not seeking comments on the illustrative directions. We plan to publish and consult on draft directions closer to the go-live date for the NPA before giving them to Pay.UK and any relevant CIS provider. According to Pay.UK's baseline plan, the NPA will go live in mid-2024. The draft directions we consult on may differ from those set out in Annex 3, in particular to take account of the circumstances at the time including any changes to the design of the NPA.
- 7.5** Once our directions are in force, we will monitor the actions taken to comply with them.
- 7.6** As described in Chapters 3 and 5, in parallel with the NPA CIS procurement process, we will be engaging with Pay.UK and relevant potential CIS providers to understand how they intend to comply with our regulatory framework and to make our expectations clear. This includes requesting draft compliance statements before a CIS contract is signed.

**7.7** The regulatory framework described in this document is based on our assessment of the information currently available to us about the risks to competition and innovation arising from the behaviour of a CIS provider. We will monitor delivery of the NPA, including the CIS procurement and the development of overlay services. If we find that new risks have emerged or circumstances have changed, or that competition and innovation are not effectively developing in the NPA, then we will consider introducing different or further regulation. We would also be open to suggestions from stakeholders about the other ways the risks could be mitigated. As part of our monitoring work, we will also be seeking assurance from Pay.UK that the design of the NPA meets the technical design principles set out in Annex 2.

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